

Shareholders Agreement v/s Constitution Which Prevail ?

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AFRICA



Different types of SHA and Constitutions

- What is the difference between a Constitution and a Private Agreement between Shareholders?
- SHA – can be:
 - a side letter;
 - a voting agreement;
 - a sale and purchase agreement (SPA);
 - a voting agreement;
 - any form of private agreement in-between some or all the shareholders of a company;
 - Company may be part of the SHA.

John Doe Family car repair business

- John Doe has 5 children – 3 sons and 2 daughters, all grown up and married. The 3 sons work with John Doe in the family car repair business – a private limited liability company. The constitution is a standard one.
- Before retiring John Doe and transferring his shares he made his children enter into a SHA to regulate their relationship as shareholders in the Company. The SHA deals with future capital funding, share transfer restrictions, corporate governance, dispute resolution. There is no divided policy

Issues Arise in John Doe's family business

- ✦ The 2 daughters complain that all the profits have been ploughed back into the company by the 3 sons, they receive no dividends, and they wish the 3 sons to buy them out or they will sell their shares to third parties.
- ✦ The 3 sons say that the Company is their sole source of income (the daughters and in-laws have good independent jobs) and is the legacy of life time work of their father and there is a need to inject money in the business otherwise the business may collapse. They cannot distribute dividends

Issues Arise in John Doe's family business

- ✦ The 3 sons say they do not have the funds to buy the daughters out and that they have no intention to purchase these shares.
- ✦ They have the majority control at both the board and Shareholders' meetings
- ✦ The SHA provides that the majority of the board may prevent any sale of shares to any third party who is not a family member.
- ✦ The constitution does not have such restriction.
- ✦ Daughters have found a third party purchaser for a good price

John Doe has a JV GBL 1 Company

- John Doe is French wealthy investor. He invests with a US Group in connection with a submarine cable maintenance and sets up a GBL1 company in Mauritius. The constitution is a standard one.
- Madagascar, Mozambique, Tanzania, and Kenya minority shareholders join into the GBL 1 company.
- John Doe is fearful of the legal implications in the various countries and asks his French lawyers to prepare a comprehensive SHA to regulate the relationships between the shareholders in the Company.

John Doe has a JV GBL 1 Company

- ✦ The SHA is governed by Mauritius law and contains a provisions that if there is any conflict between the constitution and the SHA, the SHA shall prevail.
- ✦ The SHA includes provisions for voting of budgets and operational deficits and shortfalls as well as protection against dilution of the minority shareholders.

Issues Arise in JV GBL 1

- There are serious overruns in the operations of the cable submarine vessel. The lenders ask that there is a capital injection and that the shareholders to increase the equity.
- John Doe and his partner, majority Shareholders, are willing to increase the capital but the Madagascar, Mozambique, Tanzania, and Kenya minority shareholders refuse and say that the totality of additional financing must come from the majority who operate the company without any dilution of the minority.

Issues Arise in JV GBL 1

- Joe Doe states that the board and shareholders voted the budget and operational expenses and that the SHA provides that they must contribute in the financing obligations.
- The minority state that SHA prevents dilution and that will block any increase of capital as per the SHA.
- The financing obligation and the dilution restriction are not found in the Constitution of the Company.

Issues Arise in JV GBL 1

- ✦ The majority seek to pass a company resolution to increase the capital. Minority walks out of shareholders meeting and say it is a manifest breach of the SHA. Resolution to increase the capital is passed.
- ✦ The minority seek an injunction to prevent the resolution based on breach of the SHA.

How are we to proceed ?

- ✦ **Position in:**
- ✦ **the UK**
- ✦ **Australia**
- ✦ **Canada**
- ✦ **India**
- ✦ **Mauritius - The Companies Act**

UK - Transfer of Shares

☛ Palmer's Company law

It is stated that it is well-settled that **unless the Articles otherwise provide the shareholder has a free right to transfer to whom he will**. It is not necessary to seek in the Articles for a power to transfer, **for the Act (the English Act) itself gives such a power. It is only necessary to look to the Articles to ascertain the restrictions**, if any, upon it. Thus a member has a right to transfer his share/shares to another person **unless this right is clearly taken away by the Articles**

UK - Transfer of Shares

🔪 Gore-Browne on Companies

A shareholder has **prima facie** the right to transfer his shares when and to whom he pleases. This freedom to transfer may, however, be significantly curtailed by provisions **in the Articles**. In determining the extent of any restriction on transfer contained in the Articles, a strict construction is adopted. **The restriction must be in the Articles itself.**

UK – Transfer of Shares

🔪 Pennington's Company Law

- It is stated that shares are presumed to be freely transferable and restrictions on their transfer are construed strictly and so when a restriction is capable of two meanings, the less restrictive interpretation will be adopted by the court. **It is also made clear that these restrictions have to be embodied in the Articles of Association.**
- **Restrictions in side agreements such as shareholders' agreements are not mentioned as being permitted restrictions on share transfers**

UK – to overrule Directors

- *Automatic Self-Cleansing Filter Syndicate Company, Limited v. Cuninghame*, [1906] 2ChD.34
- The shareholders sought, through a resolution passed at a general meeting, to overrule a decision of the directors validly made within their authority under the Articles. **The Court held that the directors were not bound to accept the shareholders' resolution:** *"If the mandate of the directors is to be altered, it can only be under the machinery of the memorandum and articles themselves."*

UK - Directors

🍷 *Shaw (John) & Sons (Salford) Ltd. v. Shaw*, [1935]
2 K.B. 113, [1935] All E.R. Rep. 456 (C.A.)

*“A company is an entity distinct from its shareholders and its directors. Some of its powers may, according to its Articles, be exercised by directors, certain other powers may be reserved for the shareholders in a general meeting. **If powers of management are vested in the directors, they and they alone can exercise these powers.** The only way in which the general body of the shareholders can control the exercise of the powers vested by the article in the directors is by altering their articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove. **They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders.**”*

- *John Shaw & Sons* *Halsbury's Laws of England*, 4th ed., vol. 7(1), para. 149: Justice Hood:
 - ***“Shareholders’ agreements. Individual shareholders may deal with their own interests by contract in such way as they may think fit; but such contracts, whether made by all or some only of the shareholders, create personal obligations, or an exceptio personalis, against themselves only, and do not become a regulation of the company or binding on the transferees of the parties to it or upon new or non-assenting shareholders.”***
 - Justice Hood went on to consider and **rejected the argument that the shareholders’ agreement had the effect of amending the articles.**

UK – Increase of capital

☛ *Russel v Northern Bank Development Corporation Ltd. [1992] 1 WRL 588*

That case concerned an injunction to prevent an increase of capital in breach of a shareholders agreement. The House of Lords held that though a company cannot deprive itself of its power to alter its constitution, the members of the company could agree in a shareholders agreement as to how they will exercise their voting rights on a resolution to alter the constitution. The House of Lords held that a breach of a shareholders' agreement could be enforced by injunction in between the shareholders themselves but could not be enforced against the company itself. The reasoning being that the company could not fetter the rights and obligations as provided in the law. In such a case the remedy was in damages. The gist of the decision in *Russel* is that a company cannot promise not to exercise its statutory power and any such agreement would be invalid.

Australia

- Prof. Michael Duffy in *Shareholders Agreements and Shareholders Remedies Contract versus Statute*. Bond Law Review, Volume 20, Issue 2 ,2008

At best there can be two agreements which are inconsistent. It is stated that unhappy shareholders might bring concurrent actions and it is possible that a court might prefer to dispose of the matter on non-contractual grounds such as oppression.

Australia

🍷 *Forrest v Appleyard* (2006) NSWSC 281:

Faced with a shareholders agreement and a buyout agreement the Court accepted the buyout agreement to supersede the shareholders agreement on the basis that the buyout was statutory in nature.

Canada

• *CIPC (Ocean View) Limited Partnership v. Churchill International Property Corporation et al, 2006 BCSC 1127*

• “...a shareholders’ agreement does not supersede the articles If directors make a decision that is valid under the articles but contrary to a shareholders’ agreement, they may be liable in their capacity as shareholders for breach of the agreement, but the act of the company will not be invalid”.

• The memorandum and the articles are the company’s fundamental governing documents. The articles define the powers of the directors. Section 136 of the Business Corporations Act, S.B.C. 2002, c. 57 provides that **the directors may manage the business and affairs of the company “subject to the memorandum and articles.”** Section 12(1)(a) provides that the articles must set rules for the conduct of the company. Section 19 provides that the company and its shareholders are bound by the articles The articles can be altered only in accordance with the rules set out in the Business Corporations Act.”

India

👉 V.B. Rangaraj v V.B. Gopalakrishnan and others AIR1992SC453, [1992]73CompCas201(SC),

“The private agreement which is relied upon by the plaintiffs where under there is a restriction on a living member to transfer his shareholding only to the branch of family to which he belongs in terms imposes two restrictions which are not stipulated in the Article. Firstly, it imposes a restriction on a living member to transfer the shares only to the existing members and secondly the transfer has to be only to a member belonging to the same branch of family. The agreement obviously, therefore, imposes additional restrictions on the member's right to transfer his shares which are contrary to the provisions of the Article 13. They are, therefore, not binding either on the shareholders or on the company. In view of this legal position, the finding recorded by the courts below that the sale by the first defendant of his shares to defendants 4 to 6 is invalid as it is in breach of the agreement, is erroneous in law.”

Mauritius

- Everywhere in the Companies Act it is stated :
 - ✓ “subject to the constitution” or
 - ✓ “unless otherwise provided in the constitution” or
 - ✓ “except as provided in the constitution”.
- There is no mention anywhere of a SHA in the Act.

Mauritius

- section 272 of the Act provides that:
- Where all shareholders of a **private company** agree to or concur in any action which has been taken or is to be taken by the company –
 - the taking of that action **is deemed to be validly authorised by the company, notwithstanding any provision in the constitution of the company;**
- (7) Notwithstanding any other provisions of this Act, all the shareholders or members of a private company **may, by agreement in writing, restrict in whole or in part the discretion and powers of the directors of the company to manage the business and affairs of the company** and may confer on any person who is a party to such agreement, whether or not a shareholder, a member or director of the company, such powers and discretions as they think fit

Mauritius

- (10) *A unanimous shareholder agreement under subsection (7) shall not have effect* until all the directors of the company, and in the case of a company holding a Category 1 Global Business Licence, its management company and in the case of a company holding a Category 2 Global Business Licence, its registered agent *shall have been notified of its contents, and notice of the entry into of the agreement and its effect has been given to the Registrar.*

Mauritius

- What if the John Doe JV GBL 1 company the SHA was a unanimous one and notice given to the Registrar ?
- exceptio non adimpleti contractus*



Mauritius

What if we are dealing not with a private company but a public listed company ?

Les Ternants & Ors v M. Pitot

Mauritius

What if the private company goes into liquidation, will the SHA be enforceable?

Leedon v MPL 1



Thank you

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