

TIANRUI V SHANSHUI



serle court

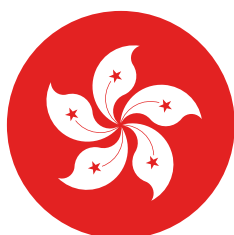
PRIVY COUNCIL AFFIRMS SHAREHOLDERS' PERSONAL RIGHT TO SUE FOR IMPROPER SHARE ALLOTMENT

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This article examines the Privy Council's decision in Tianrui (International) Holding Co Ltd v China Shanshui Cement Group Ltd [2024] UKPC 36, which affirms that a shareholder has a personal right of action to challenge an improper share allotment, even though the directors' fiduciary duty to act for a proper purpose is owed to the company (rather than shareholders). The judgment provides – for the first time at the appellate level – a principled justification for this right, grounding it in the 'corporate contract' between shareholders and the company, as constituted by the memorandum and articles of association. This decision is likely to have material implications for shareholders' rights more broadly, as the Privy Council's analysis based on the corporate contract could well be applicable to other breaches of fiduciary duties committed by directors.

Introduction

In *Tianrui (International) Holding Co Ltd v China Shanshui Cement Group Ltd* [2024] UKPC 36, the Privy Council (on appeal from the Cayman Islands) delivered an important ruling clarifying the right of shareholders to challenge share allotments that are effected by the directors for an improper purpose. The decision confirms that shareholders who have been prejudiced by such an allotment have a personal right to sue the company, notwithstanding that the directors' fiduciary duty to exercise their powers for a proper purpose is owed to the company (rather than the shareholders).



Background

The plaintiff (Tianrui) was a 28.16% shareholder in China Shanshui Cement Group Ltd (Shanshui), a Cayman-incorporated company listed in Hong Kong. The dispute arose when Shanshui's board issued convertible bonds and allotted shares to investors allegedly linked to two of its major shareholders. Tianrui claimed that these issuances were not genuine capital-raising measures but were instead designed to dilute its shareholding below 25%, thereby stripping it of its ability to block special resolutions. Tianrui issued proceedings against Shanshui in the Cayman courts seeking declaratory relief that the board had improperly exercised its power to issue and allot securities.

Shanshui applied to strike out the claim on the ground that Tianrui, as a shareholder, did not have standing to bring a personal action against Shanshui. Shanshui's strike out application was dismissed at first instance, but allowed by the Cayman

Court of Appeal, which held that only the company – and not individual shareholders – had a cause of action to challenge the directors' conduct.



Privy Council's decision

The Privy Council (with Lord Hodge DPSC and Lord Briggs JSC giving the judgment) reversed the Court of Appeal's decision, affirming that a shareholder does have a personal right of action to challenge a share allotment which was effected by the board for an improper purpose and which has caused detriment to the shareholder (e.g. dilution of his voting power).¹ The strike out application was therefore dismissed.



Shareholders' personal right of action

The Court of Appeal had based its decision on the “proper plaintiff” principle,² i.e. that where a wrong has been done to a company, it is only the company (and not individual shareholders) which can take action. The Court of Appeal reasoned that, even if Shanshui’s directors had allotted shares for an improper purpose, that was a breach of duty owed to the company, and therefore the company was the only proper claimant. This meant that a shareholder could only assert the company’s claim by way of a derivative action.

However, as the Privy Council pointed out³, the proper plaintiff principle is only part of the picture. The courts have long recognised that a shareholder has certain personal rights against a company which it can enforce by a personal action. Of particular relevance is a long line of cases in England and Australia in which the courts have allowed shareholders to bring personal claims (as opposed to derivative actions) to challenge share allotments effected for an improper purpose.⁴

Shanshui contended that, in those previous cases, the courts had not explained the juridical basis of the shareholders’ locus standi. In response, the Privy Council explained⁵ the matter from first principles: the juridical basis was to be found in the ‘corporate contract’ between shareholders and the company, as constituted by the memorandum and articles of association. It is implicit in the contract that the company’s power to allot shares would be exercised by the directors on behalf of the company in accordance with their fiduciary duties. The directors’ improper exercise of that power is actionable by a shareholder because the impropriety contravenes the corporate contract binding the shareholder and the company.

As Lord Hodge DPSC and Lord Briggs JSC explained:⁶

‘Although the action is founded upon the fact of the commission of a breach of fiduciary duty by the directors, the cause of action is that the contract between the shareholder and the company contains the implied term that, in exercising the power to allot and issue shares, the directors as the company’s agents will do so in accordance with their fiduciary duties.’

Specifically, this term is implied as a “necessary legal incident” of the relationship between a shareholder and a company, and between the shareholders inter se.⁷

Shareholders’ claim can co-exist with company’s own cause of action

The Privy Council highlighted⁸ that it is irrelevant whether or not the company itself has a cause of action against the directors for breach of fiduciary duty. The Privy Council rejected the argument that a shareholder’s claim should be barred simply because the company itself could sue the directors; the two actions are not mutually exclusive.



Size of shareholding irrelevant

The Privy Council further noted⁹ that the size of the shareholder’s shareholding is irrelevant to whether the shareholder has a personal right of action. In other

words, it does not matter whether the shareholder is a minority or majority shareholder. What is important is that the shareholder has suffered from an interference with his right as shareholder, brought about by the improper share allotment. An example of where majority shareholders had a personal cause of action was Howard Smith v Ampol¹⁰, where the directors issued shares to an outside party with the improper purpose of destroying the majority shareholders’ 55% control.



Conclusion

Although the Tianrui decision arose in the context of Cayman law, it has significant consequences for England and other common law jurisdictions. Critically, it provides (for the first time at the appellate level) a principled explanation for a shareholder’s personal right of action to challenge an improper share allotment that has harmed his position – namely, that it is founded on the corporate contract between the company and the shareholders, which includes an implied term that the directors will exercise their power to allot shares in accordance with their fiduciary duties.

The judgment is also likely to have material implications for shareholders’ rights more broadly. The Privy Council’s analysis based on the ‘corporate contract’ could well be applicable to other breaches of fiduciary duties committed by directors, with the consequence that a shareholder who has been harmed by such a breach would have a personal right to sue, rather than being compelled to pursue his remedy by way of an ‘indirect’ cause of action (such as a derivative claim, unfair prejudice proceedings, or a just and equitable winding up petition). It will be interesting to see how the courts continue to develop this line of jurisprudence.

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2 originating from Foss v Harbottle (1843) 2 Hare 461

3 [40]

4 e.g. Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821; Hogg v Cramphorn Ltd [1967] Ch 254; Ngurli Ltd v McCann (1953) 90 CLR 425

5 [70]-[74]

6 [75]

7 [76]

8 [79]

9 [77]-[78]

10 [1974] AC 821