

MOVING OUT A MINORITY SHAREHOLDER

In this paper we look at a proprietary company with several shareholders, one of who (**XYZ**) wants to get out or is wanted by the majority shareholders to get out. They cannot agree on the timing, price or other details of how that might be achieved, and look to their legal positions. That will bring in the *Corporations Act*.

Several relationships

XYZ may be in relation to the company: (a) a shareholder; (b) a director; (c) company secretary; (d) a "public officer" for taxation and WorkCover purposes; (e) an employee (wage or salary earner); (f) the holder of a trade mark or a government licence the company needs; (g) a trade supplier of goods or services; (h) a customer; (i) a guarantor to the company's trade suppliers, financiers or landlord; and/or (j) a lender or borrower of money.

Each relationship is relevant to XYZ's separation from the company.

Legal rules

Before we look at the detail, there are some legal rules to know, particularly where parties manoeuvre in an attempt to force a quick and favourable separation.

Shareholders' Rights: Ordinarily a shareholder does not have a right to separate board representation, may however vote their shares and exercise their powers as they see fit and to prefer their own personal commercial interests, and cannot be compelled to offer their shares for sale. Nor does a shareholder have a right to compel the company to buy back their shares, nor a right to compel any one else to buy the shares. The Constitution (Memorandum & Articles of Association) or a Shareholders' Agreement may vary the ordinary rules, but we assume not in our case.

Directors' Duties: The directors must under ss. 181 and 182 (and their fiduciary duty) exercise their duties and powers in good faith (including for a proper purpose) in the best interests of the company and not to improperly gain an advantage for themselves or anyone else. An improper exercise of a duty or power is invalid and may require compensation to be paid to the company.

Section 232 (Oppressive Conduct): The court may make such orders that it considers appropriate (including compelling a reinstatement, a compulsory sale and purchase of shares, or anything else) if the company, the directors or the shareholders act or propose to act in a manner oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a shareholder (*whether as a shareholder or in any other capacity*). The test here is commercial unfairness, looked at in light of the history of the company's affairs and what the owners intended when they formed or joined the company. Now once XYZ's exit is an open issue, there is a serious risk that anything the majority directors or majority shareholders do that changes the status quo or prejudices XYZ may be seen by the court to be improper and attract s. 232. The majority will need good, provable commercial reasons for conduct that changes the status quo or prejudices XYZ. One expects XYZ to argue the conduct was to pressure XYZ to sever the relationships with the company at a time not of XYZ's choosing and, in particular, to offer up the shares for sale (and perhaps at a low price).

Section 461 (Winding Up): The court may order a (still solvent) company be wound up if (in general terms) s. 232 would apply or if the directors have acted in their own interests or in any other manner that appears to be unfair or unjust to other members. Or, if the directors/shareholders are merely incapable of working together (with no wrongdoing by anyone), the court may yet order the company be wound up if that is "just and equitable". In practice however, a winding up hurts everyone and the parties search for a negotiated resolution that sees the company survive, with changed shareholders.

Applying the rules

The shares: XYZ cannot compel anyone to buy the shares and no one can compel XYZ to sell them, unless s. 232 applies. If the shares are partly paid, and the majority directors make a call on the shares, that is risky without evidence that the company has a real and pressing need for the funds called up and (perhaps) that the company could not borrow the funds on favourable terms. If the majority directors issue new shares, the same reasoning applies. If the majority directors reduce dividends from their historical levels, without good reason, that may also attract s. 232. If the majority directors refuse to register a transfer of XYZ's shares to an outsider, s. 1071F(2) entitles a

court to override that decision if the court is satisfied the refusal was without just cause. But note that a shareholder ordinarily has no right to separate board representation, and it may be that the majority directors permit a share transfer to an outsider, but not offer a directorship for the transferee.

The directorship: XYZ is free to resign the office. The majority shareholders could remove XYZ as a director, but that would deny XYZ the access to information and ability to influence the company's affairs that XYZ enjoyed historically, and may attract s. 232. And XYZ may need the latest information to be able to promote a sale of shares to an outsider (though s. 247A allows a shareholder to apply to the court for inspection of company information, for a proper purpose).

The company secretaryship: XYZ is free to resign the office. The majority directors could remove XYZ as company secretary and in itself that may do no harm, but it might be seen as part of a campaign to force XYZ from the company.

The "public officer" position: The same as immediately above.

The employment: XYZ is free to resign, on giving proper advance notice. If the majority directors dismiss XYZ as an employee, that may attract s. 232 and/or an industrial claim for unfair dismissal. At a minimum, XYZ should be given advance notice, and an opportunity to rebut any allegations of improper or inadequate service as an employee.

Trade marks and government licences: If any are in XYZ's name, the company may need to prove that XYZ holds them on trust for the company, if the company intends to retain use of them. Or XYZ and the company may need to make a formal Licence Agreement for that continued use. If a government licence (such as a builder's licence) requires the company to have a director with XYZ's personal qualifications, obviously XYZ will need replacing.

Trade supplier: This includes XYZ being the landlord to the company. XYZ may stop or reduce supplies, unless contractually obliged to supply. The company is in a more difficult position. Even assuming the company is not contractually obliged to buy supplies from XYZ, if the company stops or reduces supplies from XYZ that might attract s. 232 unless there are good commercial reasons for doing so. If the supply should survive XYZ's departure, a formal lease, supply agreement or other contract may be wise.

Customer: XYZ may stop buying supplies from the company, unless contractually obliged to buy. The company however again is in a difficult position, even if not contractually obliged to supply - if XYZ is a trader who on-sells the company's goods or services, the depriving XYZ of supplies (and profits on re-sale) might attract s. 232. A formal supply agreement is wise, if trade is to continue after XYZ's departure.

Guarantor: XYZ may terminate a guarantee, if the guarantee contract permits that. Sometimes a guarantee permits a termination only if the whole debt is paid off, or after a period of time (say 6 months) elapses between notice of termination and the effective date of termination. XYZ would want to procure an immediate and absolute release from the guarantee. The company on the other hand may see its credit position deteriorate with XYZ's withdrawal as a guarantor. A creditor of the company may be unsettled by XYZ's mere departure from the scene.

Lender or borrower: If XYZ is the lender, it may call in a loan unless the loan is contracted to be for a fixed term or requires some period of notice before being called in. If the loan is repaid, the company's working capital is reduced. If the company is the lender, it may call in a loan, subject to any loan contract. It may attract s. 232 if other shareholders are also borrowers, but only XYZ's loan is called in or interest rate or other terms changed. If a loan from or to XYZ should survive XYZ's departure, the lender might require a commercial rate of interest and/or a security over assets.

Competitor: A new item on our list. In law, XYZ is free to compete against the company before and after departing the company, subject to exceptions. One exception is where XYZ has granted a valid restraint of trade (non-competition agreement) in favour of the company. Another is where XYZ would profit personally from a commercial opportunity that came to be known because XYZ is or was then an officer of the company. Or where XYZ misuses the company's confidential information (trade secrets).

Remuneration of the majority: If XYZ retains shares but not longer works in the business, the shareholders still working in the business may think it appropriate that their own salaries be brought up to full market rates. Caution is advised, because increased salaries may mean reduced dividends on XYZ's shares. The company should get an opinion from a professional remuneration consultant, to support any increase in salaries over historical levels. Section 232 will operate if the new salaries exceed market rates.

Problems with pre-emptive rights

The Constitution in a proprietary company usually requires a shareholder looking to exit to notify the company and the company then offers the shares for sale to the other shareholders - they have a pre-emptive right to purchase. After that process, the company may offer any unsold shares to outsiders selected by the directors. Some problems:

- the vendor may be left with a few unsold shares that are harder to sell than the original parcel
- the buyers may be entitled to elect to have the price set by a valuer, so the actual price is unknown until the valuer hands down a decision
- the valuer chooses the method of valuation
- the valuer may severely discount the price of a minority parcel of shares, because they are not a controlling interest.

XYZ should look closely at the whole process, before initiating the process.

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