Minority Shareholder Protection – What Redress Can The Minority Shareholder Obtain?

As explained in the article "Protection for Minority Shareholders – Courts prepared to Shift the Balance of Power", where minority shareholders have suffered unfair prejudice due to the mis-management of the company, the Courts are now prepared to provide redress in a wide variety of circumstances and against a broad range of parties.

However, any minority shareholder considering such a claim will want to focus clearly on the potential benefit in bringing the claim. Under the Companies Act 2006 the Court has wide powers: it can make such order as it thinks fit for giving relief in respect of the issues complained of. The Act goes on to give examples of relief that can be granted – the most common of which is an order for the purchase of the of the minority member's shares either by other members or the company itself.

Other (less frequently granted) relief includes an order that the other members restore money that they have improperly diverted away from the company or to pay the company compensation for the damage caused by their wrongdoing.

If the Court orders that the minority shareholder's shares are to be bought out, the immediate question arises as to the basis on which those shares are to be valued. This subject has been dealt with by the Courts in many cases and the key points regarding the basis of valuation can be drawn from them as follows:

- If assets have been misappropriated, their value can be added back for the purpose of valuing the company and therefore the minority shareholding

- There is no general rule that the valuation of the shareholding should either be on a pro rata basis or on the basis that it is discounted due to the fact that it is a minority holding. However, a pro rata basis will generally be exceptional and there will normally be a discount for minority unless there are exceptional circumstances or the company was run as a quasi-partnership

- If the company was run as a quasi-partnership, the shareholding will normally be valued on a pro rata basis. The logic here is that the claim in a quasi-partnership is normally founded on a breakdown in trust and confidence between the parties and that in order to be free of those obligations the majority must buy the entire business.

- Even if the shareholding is a fraction under 50% (in one case it was 49.96%) it is still a minority holding and will be valued as such – generally with a discount for minority

- If the shareholders are investors it is more likely that the court will make a discount for minority

- The date of valuation will normally be the date on which the purchase order is made. However the Court will consider an earlier valuation date (for example the date on which the proceedings were commenced or the date of the acts complained of). Some examples of instances where the Court has ordered an early valuation date are:

    - Where the company has been deprived of its business and it is fair to the minority shareholder that the valuation should be at a point in time before this occurred

    - Where the company has been reconstructed or the business has changed significantly prior to the order. This can occur where for example the business has been built up significantly after the minority shareholder ceased to be involved and in that situation the Court may deem it unfair that the valuation should include the post – departure improvement in value

    - If there has been a general fall in the market since the claim was brought, and the Court has registered strong disapproval of the respondents' conduct

    - If the respondents have been guilty of severely prejudicing the minority shareholder(s) and/or have refused to engage constructively in negotiations aimed at resolving the minority shareholder's claim

- Generally interest will not be awarded

The key parameters for valuation under a purchase order are therefore reasonably clear.

In principle at least, a minority shareholder who is considering an "unfair prejudice" claim can therefore make a reasonable estimate of the value of the shareholding and hence the claim before embarking on the calim process itself.

Nevertheless, the Court will need to be guided by independent expert valuation evidence. Fairness would suggest that each side ought to be able to bring forward expert evidence. However, there have been cases recently where the opposing expert evidence has been wholly at odds, leading the Court to comment that this is unhelpful and that it is preferable for there to be a single joint expert. In this way the potential for the experts to present opposing extremes is avoided.

A minority shareholder considering the option of an unfair prejudice claim can therefore take these valuation points in to account when assessing the risk/reward ration of actually pursuing the claim.