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Shareholder and director remedies under Bermuda law

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There are approximately 16,000 companies registered in Bermuda, of which approximately 14,000 are international companies. As a result, Bermuda is a jurisdiction which deals with a large number of corporate governance disputes. Those disputes often involve individuals and entities which may be relatively unfamiliar with the remedies available to directors and shareholders under Bermuda law.

When a corporate governance dispute arises, the available remedies are likely to be found in Bermuda's *Companies Act 1981* and the common law. Some of those remedies may be well known and subject to extensive judicial commentary by the Bermuda courts. If not, the Bermuda courts will often look to the English law for guidance, since much of the *Companies Act 1981* and its associated common law principles have been adopted into Bermuda law from the English law.

Understanding the available remedies, and selecting the most appropriate remedy in the circumstances, is often one of the most critical decisions that shareholders and directors must make when dealing with a corporate governance dispute. Applying for a remedy which is not available in the circumstances or is unlikely to be granted by the court based on the facts, can doom a legal claim from the very beginning.

This article provides an overview of some of the most common remedies which may be available to shareholders and directors under Bermuda law. While no dispute is ever the same, one or more of the following remedies is likely worth consideration by any shareholders and directors looking for assistance with the resolution of an ongoing corporate governance dispute.

Just and equitable winding up orders

Section 161(g) of the *Companies Act 1981* allows the court to order the winding up of a company when it is "*just and equitable*" to do so in the circumstances. A winding up order generally represents the "*nuclear option*" for resolving a corporate governance dispute because it brings the company to an end and results in the distribution of the company's assets.

The court is likely to find that it is just and equitable to wind up a company when, for example, the board of directors is deadlocked and the company cannot properly function any longer, or when the company has suffered a "*loss of substratum*" because its original purpose has been achieved, or it is no longer possible to achieve that original purpose.

A petition seeking a just and equitable winding up order can be filed by the company itself, the company's contributories, the company's creditors, or even Bermuda's Registrar of Companies. The applicant must publicly advertise that a winding up petition has been filed, among other procedural requirements imposed by Bermuda's *Companies (Winding-Up) Rules 1982*. The advertising requirement is imposed because any of the company's contributories and creditors are entitled to attend the court's hearing of the winding up petition and make submissions in response.

Certain companies may attract special requirements which must be satisfied before they can be wound up, such as insurance companies and companies governed by their own private legislation. For example, a captive insurer may require the consent of the Bermuda Monetary Authority and/or the Registrar of Companies before a winding up petition can be filed, or before the court can grant a winding up order.

As part of granting a winding up order, the court will appoint liquidators to replace the directors of the company. The liquidators are often individuals proposed by the applicant. The court also has the power to appoint provisional liquidators on an *ex parte* basis if the applicant can prove that it is necessary in the circumstances to do so, such as if there is a real risk of the company's assets being dissipated.

A judicial stay of proceedings against the company is also imposed once the court makes a winding up order or otherwise appoints provisional liquidators. The stay only automatically applies to Bermuda proceedings and must be recognised by foreign courts in order to be applicable abroad.

Liquidators appointed by the court as part of a winding up proceeding are required to distribute the company's assets *pari passu* among the company's creditors and, once the company's debts are satisfied, among its shareholders. Court-appointed liquidators also have the power to investigate the past affairs of a company as part of a winding up proceeding.

Shareholder oppression remedy

Section 111 of the *Companies Act 1981* allows registered shareholders of a Bermuda company to apply to the court for a remedy when subjected to conduct which is oppressive or unfairly prejudicial to their interests as shareholders. The oppressed shareholders can seek relief against both the company and its directors personally.

There is a strict test under Bermuda law which applicant shareholders must satisfy before the court will grant an oppression remedy. The test generally requires proof that the applicant shareholders have been subjected to unfairly prejudicial conduct, that the oppressive conduct was so bad it would otherwise be just and equitable to wind up the company, but that it would be unfairly prejudicial to the oppressed shareholders to wind up the company in the circumstances. Proving oppression usually requires bad faith. It is not enough that there were errors in judgment or poor management decisions at the company.

If the court finds that shareholders have been oppressed, the court is empowered to "*make such order as it thinks fit, whether for regulating the conduct of the company's affairs in future, or for the purchase of the shares of any members of the company by other members of the company or by the company*." In other words, the court can effectively impose whatever remedy it wants, including by requiring the company's directors to take or refrain from taking certain actions. However, the usual remedy granted is to promote a "*clean break*" between shareholders by requiring the company to purchase the shares of oppressed shareholders at fair value (which will likely be determined by the court based on expert evidence).

In practice, a section 111 oppression remedy and a section 161 winding up order are considered to be alternative remedies. The court discourages shareholders from filing petitions which seek both an oppression remedy and a just and equitable winding up order as alternative relief.

Derivative actions

Derivative actions are governed by Order 15, rule 12A of Bermuda's *Rules of the Supreme Court 1985* and the common law. A derivative action can generally be commenced by registered shareholders filing a Writ of Summons which seeks damages for a loss suffered by the company. Once the proceeding is commenced, the applicant shareholders must apply to the court for leave to continue the derivative action in accordance with Order 15, rule 12A.

Derivative actions can be commenced by shareholders against a company's directors and other third parties personally to recover a loss suffered by the company which arises in relation to the directors' breach of duty. Obtaining leave to continue a derivative action generally requires the applicant shareholders to prove that the litigation is a reasonable and prudent course to take in the interests of the company. However, the requirements of the common law test for a derivative action makes it quite difficult for shareholders to obtain leave to continue such an action.

To obtain leave, shareholders must demonstrate "*clean hands*" (e.g., no acquiescence and that the shareholders are working in the best interests of the company), as well as show that the claim falls into an exception to the rule in *Foss v Harbottle*, [1843] 2 Hare 461 (Ch). The rule in *Foss v Harbottle* generally requires that the company which has suffered the loss must commence the claim to recover its own loss. The rule prevents individual shareholders from commencing a claim on behalf of the company unless a recognised exception to the rule applies.

One exception to the rule in *Foss v Harbottle* is proving that there has been a "*fraud on the minority*" of the company with the wrongdoers in control of the company. That means, when a company's board of directors cannot or will not bring such a claim on behalf of the company, shareholders can commence a derivative action seeking to claim on behalf of the company in order to recover the company's loss.

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Proving "*fraud on the minority*" generally requires the company's directors to be either:

- deliberately and dishonestly acting in breach of their duties to the company, or
- acting in breach of their duties in order to improperly obtain a personal benefit at the expense of the company.

Wrongdoer control means the board of directors is under the control of the wrongdoer directors and therefore unable or unwilling to commence a legal claim on behalf of the company.

The common law restricts the ability of shareholders to commence claims against directors for the breach of their duties because directors owe their duties to the company under Bermuda law (rather than to the company's shareholders). Therefore, only the company can usually bring a legal claim against its directors in response to a loss arising in relation to the directors' breach of duty, except when the wrongdoers are otherwise preventing the company from commencing such a claim.

Personal claims for loss suffered by shareholders

The common law recognises that there are certain limited circumstances when shareholders of a company can personally claim against the company's directors for a loss suffered by the shareholders which arises due to the directors' breach of duty. Such claims are generally only possible when the company itself has no cause of action against the directors, or when the shareholders suffer a separate loss which is distinct from the company's loss.

When shareholders commence personal claims against directors, the shareholders are not required to prove an exception to the rule in *Foss v Harbottle*, [1843] 2 Hare 461 (Ch), such as a fraud on the minority. That is because the claim is for a direct loss suffered by the shareholders personally, rather than a claim on behalf of the company for a loss suffered by the company.

Declarations and injunctions confirming the rights of directors

The common law allows directors of a company to apply to the court for declarations confirming their rights as directors, as well for injunctions restraining their unlawful exclusion from the management of the company. Such relief can be sought by directors against the company as well as against the company's other directors personally.

In response to such applications, the court can make orders enforcing directors' rights and restraining third party respondents from interfering with those rights. For example, the court may order compliance with the common law right of directors to review the company's records to the extent necessary for the directors to perform their duties, powers, and functions under Bermuda law.

Regulation of a company meeting

Section 76 of the *Companies Act 1981* allows directors and registered shareholders to apply to the court for an order which calls and/or regulates the meeting of a company. In response to a section 76 petition, the court has broad statutory power to "*order a meeting of the company to be called, held and conducted in such manner as the court thinks fit, and where any such order is made may give such ancillary or consequential directions as it thinks expedient.*"

Relief granted by the court can include, for example, requiring or preventing an annual general meeting from being held or determining the slate of director candidates to be put to the company's shareholders for election at a meeting. The power to grant "*ancillary or consequential directions*" also allows the court to, for example, personally restrain third party respondents (such as other directors) from interfering with the applicant directors' ability to exercise their duties, powers, and functions as directors of the company.

The court is only likely to grant relief pursuant to section 76 when there is clear evidence that a company cannot hold and/or conduct a meeting in accordance with its byelaws or the requirements of the *Companies Act 1981*. Without such evidence, the court is likely to adjourn or dismiss the section 76 petition pending further attempts by the parties to properly call and conduct the disputed meeting.

Statutory investigation of a company

The *Companies Act 1981* provides the Bermuda government with the ability to commence a statutory investigation of a company's affairs in response to a complaint by its shareholders. For example, section 110 allows the Minister of Finance (through the Registrar of Companies) to appoint an inspector to investigate the affairs of a company "*at any time of his own volition or on the application of that proportion of the [shareholders] of a company, as in [the Minister's] opinion warrants the application…*"

Based on the findings of the statutory investigation, the Registrar of Companies may apply to the court on behalf of the company's shareholders for an oppression remedy pursuant to section 111 of the *Companies Act 1981*. Statutory investigations are relatively rare in Bermuda but are still a realistic option depending on the circumstances of the dispute.

Conclusion

There are many remedies available to shareholders and directors under Bermuda law in response to corporate governance disputes. This article only summarises the most commonly available remedies. Determining the most appropriate remedy to pursue will depend on the circumstances of each dispute.

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Some remedies allow the court to grant very broad relief but impose a heavy burden of proof on the applicant before the court will grant the requested relief. Other remedies are designed to provide relief in only a very narrow set of limited circumstances. It is therefore important for litigants to seek Bermuda legal advice at an early stage of their dispute. An experienced legal advisor is key to ensuring that the most appropriate remedy is selected in the circumstances in order to resolve each particular dispute.

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