Cayman Islands: Minority shareholder rights and corporate governance: the implications of the judgment in Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd

December 2024

Introduction

The recent Privy Council ruling in *Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd* [2024] UKPC 36 has significant implications for Cayman Islands company law, insofar as the judgment clarifies critical principles governing derivative actions and the rights of shareholders (including minority shareholders) to bring them as compared to when they have standing to bring a claim. In this Legal Insight we provide an overview of the case and its significance.

Background

The dispute in the case arose between Tianrui (International) Holding Company Ltd ("**Tianrui**"), a minority shareholder in China Shanshui Cement Group Ltd ("**China Shanshui**"), a company incorporated in the Cayman Islands and listed in Hong Kong. Tianrui alleged that the board of directors of China Shanshui (the "**Board**") engaged in misconduct, including breaches of fiduciary duties and self-dealing. Tianrui sought to bring proceedings to address the alleged misconduct.

The history of the case involved a "prolonged battle" for ultimate control of China Shanshui whose core business was the production, distribution and supply of cement and other construction materials throughout The People's Republic of China. Following the allotment of shares to the holders of certain convertible bonds in China Shanshui, Tianrui alleged that the recipients of those allotments were connected to other shareholders who were competing with it for ultimate control of China Shanshui. The allotment of shares in question resulted in Tianrui's shareholding being materially diluted (following the dilution, Tianrui was no longer able to block the passing of a special resolution as its shareholding dropped below 25%) and Tianrui therefore argued that this amounted to an improper exercise of the Board's power to issue shares.

China Shanshui's counter argument was that Tianrui was not entitled to bring its claim directly, on the basis that any claim should be brought as a derivative claim on behalf of China Shanshui against the Board. Under Cayman Islands law, derivative actions are an exception to the general rule that only a company itself can sue to remedy wrongs done to it – often referred to as the rule in *Foss v Harbottle*.

Key legal issues

The Privy Council (the last court of appeal for Cayman Islands legal proceedings) was asked to determine:

1. *Whether Tianrui could bring a derivative action*: Tianrui needed to show that the alleged misconduct amounted to a "fraud on the minority" and that China Shanshui itself was unable to act because the Board was complicit in the alleged wrongdoing.

2. *Fiduciary Duties of Directors*: The case scrutinised the Board's duties to China Shanshui, particularly their obligation to act in its best interests and their duty to avoid conflicts of interest.

3. *Corporate Governance Principles*: The Privy Council had to balance shareholder remedies with the fundamental principle of corporate autonomy, which dictates that companies should generally control their own business and affairs without interference.

Against the above matters, the Privy Council had to consider many decades of prior jurisprudence on derivative actions. Whilst some of the cited cases provided that a perceived improper dilution of a shareholder's interest could form the basis of a derivative action, the established case law was either vague, contradictory or silent on the legal basis of a claim being brought by a shareholder directly.

Legal framework for derivative actions

Derivative actions are a unique aspect of corporate law designed to protect shareholders in exceptional circumstances. To succeed in bringing such an action, a claimant must satisfy the following strict criteria:

1. *Fraud on the Minority:* The claimant must prove that the directors of the company in question engaged in fraudulent or oppressive conduct, harming the company and its shareholders.

2. *Control of Wrongdoers*: The claimant must show that the wrongdoers in question have effective control of the company, leaving it unable to bring the action itself.

The Court must also consider the overarching principle of corporate personality, ensuring these actions do not undermine the company's governance structure and fundamental autonomy as a body corporate in its own right.

Arguments presented

Tianrui argued that the Board misused their powers for personal gain and failed to act in China Shanshui's best interests. Specifically, Tianrui alleged that certain decisions taken by the Board unfairly diluted its shareholding (as described above) and improperly favored other shareholders in China Shanshui.

In resisting Tianrui's submissions, the Board contended that their actions were lawful and had been made in good faith to safeguard China Shanshui's stability and prospects. The Board further argued that the derivative action that Tianrui was attempting to bring was an inappropriate means for Tianrui to challenge decisions taken by the Board.

The Privy Council's Analysis and Outcome

In its judgment, the Privy Council sought to strike an appropriate balance between the fundamental and long-established legal principles and more practical matters, and found as follows:

1. *Directors to act properly*: on the basis that the memorandum and articles of association of a company are a statutory contract between the company in question and its shareholders, it follows that the directors of the company must exercise the powers that are given to them (including the power to issue shares) under those memorandum and articles of association for proper purposes.

2. *Fraud and Wrongdoing*: The Court agreed that derivative actions require evidence of serious misconduct. The Privy Council held that Tianrui had successfully demonstrated that the alleged conduct could qualify as a "fraud on the minority", if proven. In particular, it was noted that the dilution of shareholders, particularly where the effect of that dilution removes practical rights from minority shareholders (such as the ability to block a special resolution from being passed), can be an improper exercise of the directors' ability to issue shares.

3. *Control by Wrongdoers*: The Privy Council acknowledged that derivative claims are a vital tool which is available to protect shareholders where the alleged wrongdoers dominate the company's decision-making processes. Tianrui established that those who were allegedly responsible for the misconduct in question retained effective control of China Shansui, thus effectively blocking any other remedy that might be available.

4. *Fiduciary Duties*: Directors have a duty to act in good faith and to prioritise the company's best interests over their personal interests or those of their affiliates. The Privy Council emphasised that breaches of this duty are central to shareholder protection. It follows that the ability to bring such a claim is not just the preserve of minority shareholders; if the criteria for bringing such a claim are met, any shareholder (including majority shareholders) could bring a claim.

5. *Corporate Governance*: The judgment highlighted the need to balance minority shareholder protections with the principle of corporate autonomy. While derivative actions are an essential remedy, the court stressed their use should remain limited to prevent interference with legitimate board decision-making.

The Privy Council ultimately ruled in favor of Tianrui, thus allowing the derivative action that was sought by Tianrui to proceed. It confirmed that the allegations, *if proven*, would constitute serious breaches of fiduciary duty by the Board and would justify the intervention of the Court.

This decision underscores that derivative actions are not to be taken lightly. The claimant must present clear evidence of wrongdoing and demonstrate that the company itself cannot pursue the claim.

Practical Implications

This case offers valuable lessons for shareholders, and directors:

1. *For Shareholders*: Minority shareholders who are seeking such a remedy must be prepared to meet the high bar that is set in order for such an action to proceed. Those who suspect wrongdoing should carefully and accurately document evidence of alleged wrongdoing contemporaneously in a way that proves both misconduct **and** the company's inability to act. Meeting only one of these standards alone will be insufficient to enable such an action to proceed.

2. *For Directors*: Directors should be mindful of their fiduciary duties, exercise their powers only for a proper purpose and should ensure that their decisions withstand objective, and possibly judicial, scrutiny. Transparent and well-documented decision-making processes can mitigate the risk of challenges to decisions made and/or help to defend against these challenges. Directors of companies would therefore be well advised to do the following.

   (a) Ensure that full and accurate minutes are kept of all important decision-making processes. Such minutes should be sufficiently detailed and should contain a full and accurate consideration by the directors of the pros and cons of the proposed actions and should outline why the directors consider them to be appropriate and to be in the company's best interests. Any finding by a Court as to whether there has been wrongdoing and whether a claim can be brought are, necessarily, subjective in each case. In the event of any challenge, these records will be valuable evidence and could ultimately be determinative.

(b) Fully and properly disclose any personal interest(s) in matters which are to be considered by them in the course of their role as director. Whilst this is both a necessary and fundamental principle of good corporate governance and required (usually) by the articles of association of the company, this can also go some way to demonstrating that the directors in question are acting in good faith. Directors should therefore familiarise themselves with the provisions of the articles of association relating to the disclosure of their interests and whether they are permitted to continue to form part of the applicable quorum and/or to vote on the matter, irrespective of such interest. They should also consider that where they are so interested, the fact that they are permitted to count in the quorum and vote on the matter, does not mean that they should do so.

Conclusion

The Privy Council's judgment in *Tianrui v China Shanshui* serves as a significant clarification of derivative action principles in the Cayman Islands. By allowing the case to proceed, the Privy Council reinforced the importance of holding directors accountable while ensuring that shareholder remedies do not disrupt proper corporate governance.

This decision also highlights the Cayman Islands' commitment to maintaining a robust legal framework for resolving corporate disputes, preserving its reputation as a leading jurisdiction for global businesses. Minority shareholders can take comfort in the availability of effective remedies where the require threshold is met, whilst directors are reminded of their fiduciary duties and their obligation to consider the interests of all shareholders when taking decisions.

Further Assistance

This publication is not intended to be a substitute for specific legal advice or a legal opinion. If you require further advice relating to the matters discussed in this Briefing, please contact us. We would be delighted to assist.

E: *robert.farrell@loebsmith.com*

E: *cesare.bandini@loebsmith.com*

About Loeb Smith Attorneys

Loeb Smith is a leading offshore corporate law firm, with offices in the British Virgin Islands, the Cayman Islands, and Hong Kong, whose Attorneys have an outstanding record of advising on the Cayman Islands' law aspects and BVI law aspects of international corporate, investment, and finance transactions. Our team delivers high quality Partner-led professional legal services at competitive rates and has an excellent track record of advising investment fund managers, in-house counsels, financial institutions, onshore counsels, banks, companies, and private clients to find successful outcomes and solutions to their day-to-day issues and complex, strategic matters.

Investment Funds
Mergers & Acquisitions
Capital Markets & Privatizations
Banking & Finance
Corporate Governance and Regulatory Compliance
Blockchain Technology, AI and Web3
Private Equity & Venture Capital Investments
Corporate Insolvency and Restructuring
Insurance and Re-insurance
Logistics, Shipping & Aviation
Fintech and Cryptocurrency
Bankruptcy Restructuring and Corporate Recovery
Intellectual Property
Cybersecurity and Data Privacy
Private Wealth, Trusts and Family Offices
Corporate Services and Liquidation
Real Estate and Infrastructure
Energy and Resources
Commercial Disputes & Litigation