

WHEN DIRECTORS FALL OUT- BREAKING THE DEADLOCK:

Managing Director exceeded his powers

Smith –v- Butler [2012] EWCA Civ 314

The Court of Appeal Civil Division on 15 March 2012 decided that the Managing Director had exceeded his authority in taking action against the Company Chairman by suspending him and excluding him from the premises.

Background

The Managing Director, Mr Butler was the minority shareholder. The only other shareholder was Mr Smith who held the majority and was Company Chairman. Both were Directors and the Board was completed by a third, the Group Finance Director. There was no Shareholders Agreement.

Mr Smith was intending to appoint a Chief Executive Officer to the Board and there were cross allegations between the shareholders of financial impropriety. The two other Directors then suspended Mr Smith, requiring him to leave the company premises and he was excluded from the business.

HHJ Behrens sitting at the Chancery Division, Leeds District Registry held that this was in breach of the Articles of Association which required a quorum of two Directors, one of whom had to be Mr Smith. A quorum of two was also required for Shareholder meetings. Mr Smith had attempted to call a Shareholders meeting. However there was deadlock, because Mr Butler refused to attend.

Decision

The Court of Appeal upheld the Judge's decision that the suspension of Mr Smith was invalid. The Chairman's entitlement to an order under Section 306 of the Companies Act 2006 was also upheld. This permits the court to require a General Meeting to take place where it has become impractical to hold a meeting. There was no implied or actual authority for the Managing Director to suspend the Chairman.

To resolve the log jam, under Section 306 (4) the court was entitled to deem that a single member at the meeting constituted a quorum. Because Mr Butler had no authority to direct the company to actively defend Mr Smith's applications, Mr Butler was held liable to pay the company's costs on an indemnity basis. This was because proceedings had been brought in the company's name without authority.

The company could have avoided significant expense by filing a simple Defence confirming it would abide by the order made by the court.

Action Points

The decision helps clarify the powers of Managing Directors on which there is surprisingly little case law. The court was prepared to protect the balance of power as provided for in the Articles, which were unusual in that they specifically provided that Mr Smith as majority shareholder had to be one of a quorum of two. His entitlement to exercise his ordinary voting rights on a point and remove Directors was upheld.

This perhaps underlines the importance of also having a properly drawn up Shareholders Agreement in small companies/quasi partnerships. This would usually govern the relationship between the majority and minority shareholders.

Instead of taking the steps held to be unlawful, the route of redress for Mr Butler would have been by way of an unfair prejudice claim or a derivative action. Mr Butler had the right to seek relief from allegedly unfairly prejudicial conduct by the majority shareholder under Section 994 of the 2006 Act by presenting a Petition for an order that either he or the company purchase Mr Smith's shares at fair value. Alternatively, Mr Butler could have brought a statutory derivative action against Mr Smith in accordance with Part 11 of the 2006 Act.

J Paul Sykes LLB LLM

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