

## Is there a requirement for good faith in shareholder relationships?



The rule of the majority is the starting point in shareholder relationships but when does a duty of good faith override this?

### The default position

As a minority shareholder in a company you have only limited formal rights under the Companies Act 2006 ('the Act'). The Act generally preserves the principle of majority rule. This means that shareholders are generally free to act in their own interests and use a majority vote to prefer those interests.

The Act specifies the majority required for certain decisions. For example, to remove a director of a company you need more than 50% of eligible shareholders (by number of shares) to vote in favour. However, to amend the articles of association of the company you would require at least 75% of those eligible shareholders to vote in favour.

Provided that you can pull together these majorities then you can pass shareholder resolutions which are binding on the minority.

### Protection for minority shareholders

The Act does however provide a safety net for minority shareholders. Section 994 of the Companies Act 2006 ('s. 994') provides a minority shareholder with the ability to seek a remedy from the court if they are suffer "unfair



prejudice” as a result of the actions of majority shareholders.

What amounts to unfair prejudice is often a matter for considerable legal argument. For more guidance in this respect please see our [‘guide to the law relating to shareholder disputes’](#).

In broad summary, the relief is usually available where the exercise of the majority’s legal rights (e.g. removing a minority shareholder as a director of the company) infringes the legitimate expectations of that minority shareholder. These legitimate expectations are often very fact specific but typically relate to shared understandings between shareholders or promises made by one shareholder to another.

## What is meant by good faith?

Key elements of the duty of good faith are acting honestly, fidelity to any bargain between the parties, transparency and a regard to the interests of the party to whom the duty is owed.

In broad terms the duty of good faith is breached by conduct which would be regarded as commercially unacceptable to reasonable and honest people. It is not necessary for such conduct to be dishonest.

## When does a duty of good faith arise in shareholder relationships?

It can be seen that if there is a duty of good faith then a minority shareholder may have greater protection than that otherwise provided under s.994. The duty of good faith imposes a wider obligation on the majority shareholders to act having regard to the interests of the minority shareholder.

The starting point under English law is that a duty of good faith does not automatically arise between shareholders. In other words, there is no positive obligation on majority shareholders to have regard to the interests of minority shareholders. They must be careful to not act unfairly and fall foul of s.994, but this is a more limited restriction on their powers.

A duty of good faith may be imposed by contract, for example in a shareholders agreement. In which case this may further constrain majority shareholders from acting in a way which is adverse to the interests of minority shareholders.

However, such a duty of good faith has to be seen in the context of the wider commercial relationship between the shareholders. The Court of Appeal case of *Mark Faulkner & Ors v Vollin Holdings Limited & Ors* [2022] EWCA 1371 (‘the Compound Photonics case’) looked at this in some detail.

In summary, unless it is very clear from the wording of the agreement, such a duty is unlikely to have the effect of prescribing how the majority shareholders must act in all situations, particularly those which were not foreseen or anticipated in the contractual agreement itself. The duty will operate to reinforce the contractual terms but no more than that.

In the Compound Photonics case the minority shareholders sought to rely on a contractual duty of good faith in a shareholders agreement to enforce a requirement that they should remain directors of the company, when there was no such obligation in the shareholders agreement itself. The Court of Appeal was firm in restricting the ambit of the clause and rejected the idea that it entrenched the minority shareholders as directors.

## Summary

A duty of good faith on the part of majority shareholders is a potentially powerful weapon in the hands of minority shareholders. However, such a formal duty does not normally arise in relationships between



shareholders.

If a duty of good faith is imposed contractually then the court is unlikely to interpret it in a very broad way, limiting it in application to the contractual agreement and no wider.

If you require specific advice on a contractual duty of good faith in the shareholder context then please contact our [shareholder disputes team](#).

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