claim. In any event, the new statutory derivative claim underscores a theme that runs through CA 2006, namely, the strengthening of legal measures to counteract wrongdoing on the part of directors. The following extracts consider the application of the various statutory provisions to typical fact-scenarios. Sufficient detail of the facts is also included to give a flavour of how these issues come to court.

Statutory derivative actions are only permitted in respect of claims for breach of directors' duties: s 260(3).[23] ***Common law derivative actions are not permitted at all: s 260(2).***[24]

See *Iesini v Westrip Holdings Ltd* **[13.10]** and the dismissal of claims for restitution as not being claims in respect of breach of fiduciary duty. (Is this right? What generated the claim to restitution?)

Standing to take proceedings—permission will rarely be granted to a majority shareholder. Is this the statutory counterpart of the earlier common law's 'wrongdoer control'?

[13.03] Cinematic Finance Ltd v Ryder [2010] All ER (D) 283 (Chancery Division)

Section 260(1) refers quite generally to 'a member'. Here, the corporate claimant had become a majority shareholder in various investment companies set up for film financing when those **(p. 650)** companies failed to repay loans the claimant had made to them. The claimant alleged various breaches of duty by the defendant directors and shadow directors. The directors responded that this was not an appropriate case for a derivative action, given the claimant's control over the companies in question. The judge exercised his discretion under s 261(3) to refuse permission to continue the derivative claim.

ROTH J:

11. I accept that proceedings for a derivative claim are now comprehensively governed by the Act. But in my judgment the Act is not seeking to change the basic rule that a claim that lies in a company can be pursued only by the company or to disturb the fundamental distinction between a company and its shareholders. There is nothing to suggest that the Act intended such a radical reversal of long-standing and fundamental principles. It is relevant that this part of the Act has its genesis in the Report of the Law Commission on Shareholder Remedies, Law Commission No. 246 (1997). That report states at the outset in paragraph 1.2:

> 'The focus of the project was on the remedies available to a minority shareholder who is dissatisfied with the manner in which the company of which he is a member is run.'

12 The Report proceeded to set out 'Guiding Principles' that the Law Commission applied as governing its proposals for reform of the law. The first of these is expressed as follows at paragraph 1.9:

> '(i) *Proper plaintiff* Normally the company should be the only party entitled to enforce a cause of action belonging to it. Accordingly, a member should be able to maintain proceedings about wrongs done to the company only in exceptional circumstances.'

13. Although this part of the Act does not completely mirror the approach to be found in a combination of the Law Commission's draft bill and draft procedure rules, it clearly reflects the overall approach in the Law Commission's proposal and, in my view, one would expect very different language in the Act if it were adopting such a radically different approach that involved discarding the Guiding Principle that I have quoted. Indeed, in the Act the governing provision for the grant of permission by the court to continue a derivative claim is section 261(4) which makes clear that this is a discretion resting in the court.

14. Whilst the discretion must, of course, be exercised in accordance with established principles, in my judgment this is one such principle. I would not go so far as to say that it could never be appropriate for a

derivative claim to be brought by a shareholder holding the majority of the shares in a company. A judge must be cautious about using the word 'never' when faced with a statutory discretion and when this is not one of the enumerated circumstances in section 263(2) in which permission must be refused. And faced only with the facts of the instant case, it is impossible to envisage all the factual circumstances that might arise in other cases. But in my judgment, only in very exceptional circumstances could it be appropriate to permit a derivative claim brought by a shareholder in control of the company. For my part, I find it difficult to envisage what those exceptional circumstances might be.

➢ Note

See, too, the *obiter* comments of HHJ Pelling QC (sitting as a judge of the High Court) in *Stimpson v Southern Private Landlords Association* **[13.09]**:

46 There remains one final factor that is significant. Under the old law if there was no wrongdoer control of the company, permission would be refused for the obvious reason that in the circumstances there was no need for derivative proceedings to be commenced. It was submitted on behalf of the claimant that these principles do not appear in the statute and therefore are no longer relevant. I am doubtful if that is correct. If the statute is followed strictly, the court is required to **(p. 651)** consider whether a prima facie case is established—see s 261(2). In considering that question, the court is bound to have regard, not merely to the factors identified in ss 263(3) and (4), but to any other relevant consideration since ss 263(3) and (4) are not exhaustive. It is open to the first claimant to requisition an EGM, obtain if he can a replacement Board and that Board can if it judges it appropriate to do so, applying the duties imposed upon them by s 172, authorise the litigation. This factor is at least a powerful one that negatives the giving of permission and may be overwhelming. However, I make clear that I have reached my conclusions for each of the reasons I have identified and that I would have reached the same decision irrespective of this last point.

➢ Questions

1. Compare Roth J's comments in *Cinematic Finance Ltd v Ryder* **[13.03]** with his comments in *Stainer v Lee* **[13.05]**. Has there been a change in attitude to the statutory derivative claim?

2. *Is* the above approach the appropriate way to import what was an important underlying common law requirement of 'wrongdoer control'?

Thresholds to be reached at the mandatory first stage (s 261(2) and s 263(2)) and the discretionary second stage (s 263(3) and (4)) in order to obtain permission to continue the derivative claim.

The practical problem here is for the court to provide a gate-keeping role, and to do so fairly on the evidence, but also to do so without allowing the 'permission' stage to turn into a mini-trial or a rehearsal of the entire litigation.

[13.04] Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Chancery Division Companies Court)

The facts are irrelevant at this stage, but see **[13.10]**. Also see **[13.02]**.

LEWISON J:

78 The Act now provides for a two-stage procedure where it is the member him self who brings the proceedings. At the first stage, the applicant is required to make a*prima facie* case for permission to

continue a derivative claim, and the court considers the question on the basis of the evidence filed by the applicant only, without requiring evidence from the defendant or the company. The court must dismiss the application if the applicant cannot establish a *prima facie* case. The *prima facie*case to which s 261(1) refers is a *prima facie* case 'for giving permission'. This necessarily entails a decision that there is a *prima facie* case both that the company has a good cause of action and that the cause of action arises out of a directors' default, breach of duty (etc.). This is precisely the decision that the Court of Appeal required in *Prudential*.[25] As mentioned, Norris J considered the application on paper, and considered that there was a *prima facie* case. Hence the hearing before me.

79 However, in order for a claim to qualify under CA 2006 Part 11 Chapter 1 a derivative claim at all (whether the cause of action is against a director, a third party or both) the court must, as it seems to me, be in a position to find that the cause of action relied on in the claim arises from an act or omission involving default or breach of duty (etc.) by a director. I do not consider that at the second stage this is simply a matter of establishing a *prima facie* case (at least in the case of an application under section 260) as was the case under the old law, because that forms the first stage of the procedure. At the second stage something more must be needed. In *Fanmailuk.com v Cooper* [2008] **(p. 652)** EWHC 2198 (Ch) Mr Robert Englehart QC said that on an application under s 261 it would be 'quite wrong … to embark on anything like a mini-trial of the action'. No doubt that is correct; but on the other hand not only is something more than a *prima facie* case required, but the court will have to form a view on the strength of the claim in order properly to consider the requirements of ss 263(2) (a) and 263(3)(b). Of course any view can only be provisional where the action has yet to be tried; but the court must, I think, do the best it can on the material before it.

[13.05] Stainer v Lee [2010] EWHC 1539 (Chancery Division)

The facts are irrelevant at this stage, but see **[13.15]**.

ROTH J:

29 As regards the standard to be applied generally under section 263, Lewison J held that something more than simply a *prima facie* case must be needed since that forms the first stage of the procedure; and that while it would be wrong to embark on a mini-trial the court must form a view on the strength of the claim, albeit on a provisional basis: see at [79]. It seems to me possible, with respect, that the court might revise its view as to a *prima facie* case once it has received evidence and argument from the other side, so the antithesis between section 261(2) and 263 may not be so stark. But in any event, I consider that section 263(3) and (4) do not prescribe a particular standard of proof that has to be satisfied but rather require consideration of a range of factors to reach an overall view. In particular, under s 263(3)(b), as regards the hypothetical director acting in accordance with the s 172 duty, if the case seems very strong, it may be appropriate to continue it even if the likely level of recovery is not so large, since such a claim stands a good chance of provoking an early settlement or may indeed qualify for summary judgment. On the other hand, it may be in the interests of the Company to continue even a less strong case if the amount of potential recovery is very large. The necessary evaluation, conducted on, as Lewison J observed, a provisional basis and at a very early stage of the proceedings, is therefore not mechanistic.

[13.06] Kleanthous v Paphitis [2011] EWHC 2287 (Chancery Division)

The facts are irrelevant at this stage, but see **[13.16]**.

NEWEY J:

No threshold

39 Mr Kitchener submitted that the Court should grant permission for a derivative claim to be continued only if satisfied that the Claimant has a strong case. In this connection, he relied on a passage from *Iesini v*

Westrip Holdings Ltd **[13.04]**. In paragraph 79 of his judgment in that case, Lewison J suggested that, for the Court to give permission for a derivative claim to be continued under s 261(4), 'something more than a prima facie case' is required.

40 However, Part 11 of the 2006 Act does not in terms provide that a claim must reach a specific threshold if it is to be allowed to continue. Further, in *Stainer v Lee***[13.05]**, Roth J expressed the view [and he then cited the passage in the previous extract]…

41 Roth J's observations are consistent with the Law Commission's intentions. In paragraph 6.72 of its report on shareholder remedies (number 246), on which the relevant provisions of the 2006 Act are to a considerable extent based, the Law Commission recommended that 'there should be no threshold test on the merits'. Roth J's views are in keeping, too, with comments made in a Scottish case, *Wishart v Castlecroft Securities Ltd* [2009] CSIH 65. Lord Reed, giving the opinion of the Inner House, there said (in paragraph 40):

> '[S]ection 268 [i.e. the Scottish equivalent to section 263] does not impose any threshold test in relation to the merits of the derivative proceedings. As we have explained, the Law **(p. 653)** Commission recommended that there should be no such test, partly in order to avoid the risk of a detailed investigation into the merits of the case taking place at the leave stage, and partly to avoid the drawing of fine distinctions based on the language of a particular rule. Section 268, and the parallel provision for England and Wales and Northern Ireland in section 263, do not depart from that recommendation. That is consistent with the nature of the factor to be considered under section 268(2)(b): it is possible to conceive of circumstances in which a director acting in accordance with section 172 might attach great importance to raising proceedings which were merely arguable, and of other circumstances in which a director might have sound business reasons for attaching little importance to raising proceedings which had good prospects of success.'

42 In the circumstances, it seems to me that the Court can potentially grant permission for a derivative claim to be continued without being satisfied that there is a strong case. The merits of the claim will be relevant to whether permission should be given, but there is no set threshold.

➢ Note

In some cases, the court has been inclined to merge the two stages into one, and to consider the application for permission in one single hearing: *Mission Capital plc v Sinclair* **[13.07]**; *Franbar Holdings Ltd v Patel* at [24] **[13.08]**; *Stimpson v Southern Private Landlords Association* at [3] **[13.09]**. In such cases, it is arguable that the distinction between the requisite thresholds becomes of little significance, as the judge will simply embark on an overall analysis of the evidence and submissions put by both sides in order to decide whether permission should be granted. Whether the threshold in the second stage is higher than that required in the first stage, therefore, is neither here nor there, because there will not be a second stage in some of these cases.

The court must refuse permission to continue the claim if a person acting in accordance with s 172 (duty to promote the success of the company) would not seek to continue the claim (s 263(2)(a)). If that hurdle is met, then, in exercising its discretion to grant permission, the court must consider the importance that a person acting in accordance with s 172 would attach to continuing it (s 263(3)(b)).

[13.07] Mission Capital plc v Sinclair [2008] EWHC 1339 (Chancery Division)

Two former executive directors (S) (father and daughter) unsuccessfully sought permission to continue a derivative

claim. M, via its three non-executive directors, had terminated S's employment and dismissed them as directors on the basis that they had failed to meet financial forecasts and submit important financial information to the board. S brought a derivative claim against M, the non-executive directors and their replacement director (P), claiming that M would suffer damage from their wrongful dismissal, and that P would act improperly.

FLOYD J:

43 Although I could not be satisfied that the notional s 172 director would not continue the claim, I do not believe that he would attach that much importance to it. Would a company which had wrongfully dismissed a director normally take action against those responsible for the damage that it has suffered? It would depend, but I suspect that the action it would take in preference would be to replace the directors. Moreover, on the evidence before me the damage the Company will suffer is somewhat speculative—another reason why the s 172 director would not attach great weight to it. [And in any event, S could seek a remedy under s 994 (unfair prejudice) for the harm suffered.]

(p. 654) [13.08] Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Chancery Division)

Medicentres (M) was a company established to provide primary health care and medical services. It was wholly owned by Franbar (F) until July 2005, when F sold 75% of the shares in M to Casualty Plus (C). F and C entered into a shareholders' agreement pursuant to which C appointed two directors to M (Mr Patel and Dr du Plessis (P)) and F appointed one (Mr Lalani (L)). The agreement also gave each party an option to sell or call for the remaining shares at a price nine times M's earnings before interest, tax, depreciation and amortisation as derived from its most recent audited accounts. F brought derivative proceedings against C and P, claiming negligence, default and various breaches of duty of care owed by P to M, including claims that P drove down M's share price by driving business away from it. William Trower QC, sitting as a deputy judge of the High Court, refused permission to continue the claim because he thought that a person acting under s 172 would not attach *great* importance to the claim, and that there were alternative modes of redress which would enable Franbar to claim what it was now seeking.

MR WILLIAM TROWER QC:

28 The duty under s 172 to act in the way that the director considers, in good faith, would be most likely to promote the success of the relevant company for the benefit of its members as a whole, having regard amongst other matters to a number of listed criteria. Mr Sisley [counsel] has sought to persuade me that I can be satisfied that directors acting in accordance with s 172 would not seek to continue the claim because Franbar has not established a sufficiently cogent case on the merits to lead a reasonable director to conclude that the continuation of the claim would be in the best interests of Medicentres. In particular, he submits that the evidence in Mr Lalani's witness statement is of such low quality that the hypothetical director would not seek to continue the claim on that ground alone. …

29 Franbar contends to the contrary. It says that the allegations made are so serious and have caused such serious losses that the hypothetical director contemplated by s 263(2) would undoubtedly seek to continue the claim. …

30 In my judgment, this is one of those cases in which there is room for more than one view. Directors are often in the position of having to make what is no more than a partially informed decision on whether or not the institution of legal proceedings is appropriate, without having a very clear idea of how the proceedings will turn out. Some directors might wish to spend more time investigating and strengthening the company's case before issuing process, while others would wish to press on with proceedings straight away; in a case such as this one, both approaches would be entirely appropriate. It is my view that there is sufficient material for the hypothetical director to conclude that the conduct of Medicentres' business by those in control of it had given rise to actionable breaches of duty. As it seems likely that Mr Patel and Dr du Plessis were behind much of that conduct, I cannot be satisfied that a hypothetical director acting in

accordance with s 172 would conclude that the case advanced was insufficiently cogent to justify continuation of the claim. Even though he may take a healthily sceptical approach to Medicentres' ability to prove the allegations at trial, it does not follow that the claim should not be continued on that ground alone. [So the first hurdle was met.]

…

36 In my judgment, the hypothetical director acting in accordance with s 172 would take into account a wide range of considerations when assessing the importance of continuing the claim. These would include such matters as the prospects of success of the claim, the ability of the company to make a recovery on any award of damages, the disruption which would be caused to the development of the company's business by having to concentrate on the proceedings, the costs of the proceedings and any damage to the company's reputation and business if the proceedings were to fail. A director will often be in the position of having to make what is no more than a partially informed decision on continuation without any very clear idea of how the proceedings might turn out.

(p. 655) 37 Franbar asserts that great importance would be attached to continuing the claim because there is no other means of securing compensation for the breaches of duty that it pleads. In my judgment, the difficulty with this submission is that the complaints are not yet in a form in which the hypothetical director might be expected to conclude that there were obvious breaches of duty which ought to be pursued and that the recovery to be expected in consequence of those breaches would be substantial. I also think that it is likely that the hypothetical director would be more inclined to regard pursuit of the derivative claim as less important in the light of the fact that several of the complaints are more naturally to be formulated as breaches of the Shareholders' Agreement and acts of unfair prejudice which are already the subject matter of proceedings commenced by the minority shareholder. I accept Mr Sisley's submission that, in the present case, where all parties seek and have offered (as the case may be) a buy-out of the minority by the majority and the principal issue is one of valuation, that means that the hypothetical director would be less likely to attribute importance to the continuation of the derivative claim. [And, accordingly, he refused permission to continue.]

[13.09] Stimpson v Southern Private Landlords Association [2009] EWHC 2072 (Chancery Division)

Southern Private Landlords Association (first defendant) was a non-profit company limited by guarantee, whose function it was to represent the interests of private landlords. The sixth defendant was also a company limited by guarantee, and who performed similar services, but on a large scale. The first claimant was the founding president and a director of the first defendant whose voting capacity was, however, limited to breaking deadlocks on the board. The remaining defendants were statutory (or, in the case of the fifth director, shadow) directors of the first defendant. In this application under s 261, the claimants alleged that the director defendants had engineered the transfer of all the assets of the first defendant to the sixth defendant, in breach of their duties. Taking into account the merits and value of the claim, as well as the likely costs of the litigation and that the first claimant would seek to recover his outlay from the first defendant, HHJ Pelling QC (sitting as a judge of the High Court) refused the application under s 263(2) on the basis that a hypothetical director acting under s 172 would not seek to continue the derivative claim.

HHJ PELLING QC (sitting as a judge of the High Court):

24 Thus the real first question to which I now turn is whether a hypothetical director acting in accordance with s 172 of the 2006 Act would not seek to continue the claim.

…

26 Section 172(1) refers to the requirement that a director must act in a way he considers would most likely promote the success of the company for the benefits of its members as a whole. However, that provision has to be read subject to s 172(2). This provision contemplates two different situations—that where the objects of the company consist of purposes other than the benefit of its members and that where the

purposes of the company include purposes other than the benefit of its members. In relation to the first of these situations, s 171(1) is to be read as providing that a director must act in a way that he considers in good faith would be most likely to achieve those purposes. Although it was suggested by the defendants that the first of these constructions applies to both of the situations I have identified and that such a construction would have an impact in the circumstances of this case, I reject that submission. To adopt such an approach would be to apply a test that would be entirely inappropriate to a company with mixed objects because it would require the benefit of its members to be ignored (even though the benefit of members was one of its objects) or suborned to the other objects. Such a test would be progressively more inappropriate depending on how relatively unimportant the other objects were both on a consideration of the relevant objects clause and as a matter of practicality. In my judgment s 172(1) is to be construed as meaning that a **(p. 656)** director of a company with mixed objects must act in a way that he considers in good faith would most likely promote the success of the company for the benefit of its members as a whole whilst at the same time achieving its other purposes. Where there is a conflict between promoting the success of the company for the benefit of its members and the achievement of the other objectives, a balancing exercise will be required.

…

28 Deciding whether a hypothetical director acting in accordance with s 172 of the 2006 Act would not seek to continue the claim necessarily involves considering those issues identified by Mr Trower QC in *Franbar* **[13.08]**… However, that list is not and was not intended to be comprehensive. In a case such as this answering the question under consideration also involves considering the ability of the company to provide benefits to its members after completion of the litigation, the degree to which delay in completing the litigation would affect the ability of the company to provide services for its members at all, and the degree to which the company can expect to retain members during the litigation, or regain them after it has been completed, bearing in mind that the only income that the first defendant has ever had is its subscription income.

[13.10] Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Chancery Division Companies Court)

Also see **[13.02]** and **[13.04]**. This case concerned allegations of asset-stripping. Mr Iesini and his co-claimants were shareholders in Westrip, a company formed as a vehicle to find funding for the development of a valuable mineral exploration licence (the 'Tanbreez licence'), worth about $900 million. Until a boardroom coup in June 2008, Westrip's directors included Mr Iesini, Mr Barnes and Ms Walker. Westrip entered into two licences (in 2002 and 2004 respectively) with Rimbal, an Australian company to which the Tanbreez licence was granted by the Government of Greenland Bureau of Minerals and Petroleum, to enable Westrip to control the management and implementation of the scheme for the development of the licensed areas. The shareholders of Rimbal had been Mr Barnes and Ms Walker. Under the licence agreement, Rimbal assigned to Westrip all of its present and future rights to all profits arising from any exploitation of mineral deposits within the tenement. The licences further provided for the transfer of shares in Rimbal to Westrip for a consideration of £2.5 million; however, no payment was made and therefore no shares were transferred under these two licences.

In 2006, Westrip entered into an agreement in principle with Mr Barnes and Ms Walker for the purchase of their shares in Rimbal, in consideration of redeemable preference shares in Westrip being allotted (notwithstanding that Westrip's articles of association did not provide for the allotment of such shares). Prior to this, Rimbal had acquired another exploration licence for a different area of Greenland which was later subdivided into two licences (the 'Northern Licence' and the 'Southern Licence' respectively).

Among other events on the chronology, the settlement date was postponed twice, and, after all, the transfer failed to materialise as Westrip was, by May 2008, on the brink of insolvency. Accordingly, on 8 October 2008, Mr Barnes and Ms Walker gave notice to Westrip exercising their right to rescind under the agreement (and requested the return of their Rimbal shares, which they had earlier transferred to Westrip). After obtaining legal advice, the board of Westrip re-transferred the shares in Rimbal to Mr Barnes and Ms Walker. This gave rise to the claimants' first ground for continuing a derivative claim against the board of Westrip; namely that they had allegedly breached their directors' duties in accepting the rescission of the agreement, and failing to consider such possible defences

as estoppel and waiver on the part of Mr Barnes and Ms Walker. The claimants also sought restitution for expenses incurred by Westrip on the Tanbreez licence (which, as a result of the rescission, would directly benefit Rimbal as beneficial owner of the licence). The claimants also advanced a trust claim, namely **(p. 657)** asserting that Rimbal had been holding the Northern Licence and the Southern Licence on trust for Westrip. Finally, conspiracy on the part of the board was also alleged.

Lewison J held that the restitution claim was not a valid ground for a derivative application, as it contained no allegation of default or breach of duty. The conspiracy claim was accepted by counsel to add little (if anything) to the other claims. As to the claim that the directors were at fault in accepting the rescission, the learned judge was of the view that the strength of the claim was so weak that no director, acting in accordance with s 172, would seek to continue it. Finally, despite coming to the view that the trust claim had been strong, the learned judge exercised his power under s 261(4)(c) to direct the board to reconsider Westrip's defence to the action brought by Rimbal (in relation to the beneficiary interest) as it was evident that some particular documents had not been given sufficient weight in previous legal advice supplied to the board. If the board decided to maintain a defence to the action, the need for a derivative claim would be extinguished.

> LEWISON J:
>
> 85 As many judges have pointed out (e.g. Warren J in *Airey v Cordell* [2007] BCC 785, 800 and Mr William Trower QC in *Franbar Holdings Ltd v Patel* **[13.08]**) there are many cases in which some directors, acting in accordance with s 172, would think it worthwhile to continue a claim at least for the time being, while others, also acting in accordance with s 172, would reach the opposite conclusion. There are, of course, a number of factors that a director, acting in accordance with s 172, would consider in reaching his decision. They include: the size of the claim; the strength of the claim; the cost of the proceedings; the company's ability to fund the proceedings; the ability of the potential defendants to satisfy a judgment; the impact on the company if it lost the claim and had to pay not only its own costs but the defendant's as well; any disruption to the company's activities while the claim is pursued; whether the prosecution of the claim would damage the company in other ways (e.g. by losing the services of a valuable employee or alienating a key supplier or customer) and so on. The weighing of all these considerations is essentially a commercial decision, which the court is ill-equipped to take, except in a clear case.
>
> 86 In my judgment therefore (in agreement with Warren J and Mr Trower QC) s 263(2)(a) will apply only where the court is satisfied that *no* director acting in accordance with s 172 would seek to continue the claim. If some directors would, and others would not, seek to continue the claim the case is one for the application of s 263(3)(b). Many of the same considerations would apply to that paragraph too.
>
> …
>
> 102 In my judgment this is a clear case. The strength of the claim against the board is so weak that I conclude that no director, acting in accordance with s 172, would seek to continue the claim against the directors in respect of their actions in accepting the rescission of the SSA. If I am wrong about that, the case is so weak that a person acting in accordance with s 172 would attach little weight to continuing it.

[13.11] Kiani v Cooper [2010] EWHC 577 (Chancery Division)

Mrs Kiani (claimant) and Mr Cooper (first defendant) were the sole directors and shareholders of a property development company. In this application, Mrs Kiani alleged that Mr Cooper had acted in breach of his fiduciary duties owed to the company. These allegations concerned, first, sums claimed by Mr Cooper personally as a creditor of the company; secondly, Mr Cooper's failure adequately to handle and defend claims made by DPM (third defendant), of which Mr Cooper was a director and majority shareholder; and, thirdly, sums transferred out of the company's bank account by Mr Cooper to another company, which was allegedly owned beneficially by Mr Cooper himself. Proudman J concluded that Mr Cooper had a strong case to answer and he had not yet at any rate answered it. Taking this and the other statutory **(p. 658)** considerations into account, permission to continue the claim was granted, but only down to disclosure in the action, because further disclosure of documents would

reveal the real strength of Mrs Kiani's case, and thus whether a director acting in accordance with s 172 would wish to continue the claim.

PROUDMAN J:

43 Mr Irvin [counsel for Mr Cooper] submitted under this head that the case is one for mandatory dismissal. He prayed in aid the fact that the company is deadlocked and development cannot continue. The company has ceased trading. He submitted that liquidation in one form or another was the only realistic option and the proper person to take decisions about whether there has been any breach of duty is a liquidator. I observe that although this could have been a case for the court to appoint a receiver, neither side has requested such an appointment. The evidence of Mr Rubin, an insolvency practitioner, given on the basis of information provided by Mr Cooper, is that the company may be cash flow insolvent, although it seems to be common ground that on a balance sheet basis there is a surplus of assets over liabilities. Mr Irvin submitted that faced with the practical options a director would not expend money in what might be very considerable costs of these proceedings. One of the factors specified in section 172 is the need to act fairly between members of the company. In any event Mr Irvin submitted that it would be grossly unfair to pursue Mr Cooper in circumstances where even if he won he would be bearing a significant proportion of the costs of the proceedings.

44 However, taking all the factors I have stated into account, it seems to me that so far from there being a mandatory bar on the application, a director acting in accordance with his section 172 duties would decide to continue the proceedings on the basis that at present there is some strong evidence in favour of the case advanced by Mrs Kiani. The notional director would take into account the size of the claim in relation to the payments to Cranham Facilities Limited (some £296,000), which if successful would be bound to ensure full return for all creditors. Mr Irvin submitted that the costs of such an action would be disproportionate. However, that depends on the ability to recover in full.

45 I believe that a director acting in accordance with his duty would wish to continue the claim down to disclosure. Mr Cooper says he has supporting documentation and that is the time to assess what documentation he can in fact produce. …

➢ Note

In *Stainer v Lee* **[13.05]**, Roth J also granted permission to continue the claim only up to the conclusion of discovery.

➢ Question

Is the possibility that the claimant shareholder has other avenues for seeking a remedy a good reason for refusing permission to continue a derivative claim? What does CA 2006 say? (See s 263(3)(f).) What do the judges do?

The court must refuse permission to continue proceedings if the actual or proposed wrong has been properly authorised or ratified by the company: s 263(2)(b) and (c). If that hurdle is met, then, in exercising its discretion to grant permission, the court must consider whether the company has decided not to pursue the claim: s 263(e).

Care must be taken here. The authorisation (ie before the wrongdoing) or ratification (ie after the wrongdoing) must

be proper. The rules for each are different.

In the absence of specific statutory provisions, *authorisation* is granted according to common law rules (s 180(4)), and these seem to permit the wrongdoing directors to vote (see the following Notes, p 661).

(p. 659) On the other hand, where *ratification* is in issue, s 239 applies, which adopts the common law rules with all their poorly defined limitations on what may be ratified by whom (s 239(7)), and then adds the further requirement that the wrongdoers cannot vote to ratify (unlike the common law), although they may count in the quorum and participate in the proceedings (s 239(4)). See *Franbar* **[13.12]** and the following Notes, p 661.

[13.12] Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Chancery Division)

For the facts, see **[13.08]**. Also see **[13.13]**.

MR WILLIAM TROWER QC:

38 As all of the acts and omissions relied on by Franbar have already occurred, the third relevant factor is whether those acts and omissions could be ratified, or in the circumstances would be likely to be ratified by Medicentres. Although Casualty Plus has a significant number of outside shareholders, that fact of itself does not cause me to consider that it would not vote in favour of ratification of any of the breaches of duty to Medicentres pleaded against Mr Patel and Dr du Plessis. Mr Sisley (who is also instructed by Casualty Plus in the s 994 petition and the shareholders' action) told me that this was Casualty Plus' intention. I am satisfied that Casualty Plus will, if necessary, take steps to procure a resolution ratifying the conduct complained of against Mr Patel and Dr du Plessis.

39 Any such ratification must of course be effective; merely purporting to do so cannot amount to ratification sufficient to render permission to continue inappropriate, or at least less appropriate than would otherwise be the case. Provision for the ratification by a company of conduct by a director amounting to negligence, default, breach of duty or breach of trust is made by CA 2006 s 239, although it applies only to conduct by a director on or after 1 October 2007 (Schedule 3 paragraph 17 of The Companies Act 2006 (Commencement No 3 Consequential Amendments, Transitional Provisions and Savings) Order 2007 SI 2007/2194). Conduct prior to that date is subject to the law relating to ratification applicable immediately before that date. In the present case, some of the conduct of which complaint is made occurred prior to 1 October 2007 and some occurred thereafter.

40 The ratification must be effected by a resolution of the company's members. The material part of s 239 is in the following terms …:

41 The effect of these provisions is that the vote (in his capacity as a member) of the director whose conduct is in issue and the vote of any member connected with him must be left out of account when determining whether an effective resolution ratifying that conduct has been passed. Whether a member is a connected person for these purposes is set out in CA 2006 ss 252 and 254, the material parts of which are as follows:… [And then holding that Casualty Plus was not such a person.]

43 I shall revert shortly to Mr Matthias' submissions on whether or not a particular aspect of the conduct of Mr Patel and Dr du Plessis is capable of ratification. Before doing so, I should deal with a submission made by Mr Sisley that the introduction by section 239 of an obligation to disregard connected votes means that what he describes as the 'untainted majority' can ratify any act which is not *ultra vires* the company. He contended that the connected person provisions in section 239 have replaced the principle that breach of duty by a director is incapable of ratification where it constitutes a fraud on the minority in circumstances in which the wrongdoers are in control of the company. This submission can only relate to conduct which occurred after 1 October 2007.

44 In my judgment, that is not the correct approach. Section 239(7) explicitly preserves any rule of law as to acts that are incapable of being ratified by the company. This will include acts which are *ultra vires* the company in the strict sense, but it seems to me that it will also include acts which, pursuant to any rule of

law, are incapable of being ratified for some other reason. If Mr Sisley were right, the effect of section 239 would be to restrict the types of circumstance in which ratification is not possible because of wrongdoer control to those in which the connected person requirements of **(p. 660)** section 239(3) and (4) are satisfied. He did not suggest any policy reason why that might have been the Parliamentary intention and the passages from *Gore-Browne on Companies*… and *Palmer's Company Law*… suggest that it was not. In summary, I agree with the editors of *Palmer* that the connected person provisions in section 239(3) and (4) impose additional requirements for effective ratification which draw on existing equitable rules but which impose more stringent demands (*Palmer's Company Law* (25th edn) at paragraph 8.3412).

45 It follows that I consider that the words of Sir Richard Baggalay, delivering the advice of the Privy Council in *North-West Transportation Company v. Beatty* **[4.33]**, 594, describing the circumstances in which a company cannot ratify breaches of duty by its directors, remain good law:

> '… provided such affirmance or adoption is not brought about by unfair or improper means, and is not illegal or fraudulent or oppressive towards those shareholders who oppose it.'

It follows that, where the question of ratification arises in the context of an application to continue a derivative claim, the question which the court must still ask itself is whether the ratification has the effect that the claimant is being improperly prevented from bringing the claim on behalf of the company (c.f. Knox J in *Smith v. Croft (No 2)* **[13.17]**, 185B). That may still be the case where the new connected person provisions are not satisfied, but there is still actual wrongdoer control pursuant to which there has been a diversion of assets to persons associated with the wrongdoer, albeit not connected in the sense for which provision is made by section 239(4).

46 Mr Matthias submitted that the acts complained of are incapable of ratification because their effect was to oppress the minority by driving down the value of Franbar's minority interest, in any event when seen against the background of the options contained in the Shareholders' Agreement. This might be correct in relation to a number of the breaches alleged against Mr Patel and Dr du Plessis, but it cannot sensibly be said that every breach of duty pleaded in the derivative claim is incapable of ratification merely because it caused sufficient loss to Medicentres to have an effect on the value of Franbar's shares. In my judgment, that would be to give a meaning to the concept of minority oppression which is not justified by the authorities.

47 I do, however, accept that some of the complaints made by Franbar may well be incapable of ratification. It seems to me that, if Franbar were to establish its claim that some part of the business of Medicentres, or some business opportunity which properly belonged to it, had been diverted to Casualty Plus at the suit of Mr Patel or Dr du Plessis, that may well amount to a breach of duty incapable of ratification on the votes of Casualty Plus, more particularly if it was done with the intention of driving down Medicentres' earnings and reducing the amount payable to Franbar on exercise of the option. Despite Mr Sisley's comprehensive submissions on the improbability of any such breach being established, I am unable to say at this stage that he is right. In my judgment it is possible that Franbar will establish at trial that, in all the circumstances of the case, some of the breaches alleged will prove to be incapable of ratification. In this, as in many cases, it is only possible to say at this stage that, while it is likely that an attempt will be made to ratify all of the breaches, it is no more than a possibility that ratification of all of the breaches will prove to be effective.

48 The fourth relevant matter of which I am required to take particular account is whether Medicentres has decided not to pursue the claim. Mr Matthias submitted that Medicentres has made no such decision and Mr Sisley did not contend that it had. I am able to infer, however, that if it were to engage in a formal consideration of whether or not to pursue the claim, Medicentres would decide not to do so. In a case such as the present, this seems to me to add little to the issue of ratification which I have already considered.