Suffolk Properties Ltd [1989] BCLC 100 (Ch)).

(iv) Individual members, using the statutory procedure that allows them to take a '*derivative action*': Companies Act 2006 (CA 2006) ss 260ff. A derivative action is taken in the name of the member, but in pursuit of a claim that belongs to the company, and for a remedy that will accrue to the company and not to the member as an individual. The company is brought before the court compulsorily (and so as a *defendant*, rather than a claimant), so as to ensure that it is subject to the jurisdiction and orders of the court in circumstances where those with actual power to cause the company to pursue its own claims are resisting this option.[1]

(v) The Secretary of State, under powers set out in the Companies Act 1985 (CA 1985) s 438 (see 'Public investigation of companies', pp 730ff; note, these few CA 1985 provisions remain operative).

Actionable wrongs committed against individual members

If a wrong has been done to the member personally (rather than to the company), then the member may pursue his or her claim against the company, or against the other (ie majority) members in the company, by way of:

(i) A *personal action* (or a *representative action*[2]) based on the contract the member has with the company as set out in the company's constitution (CA 2006 s 33) (see 'Members' personal rights', pp 250ff).

(ii) A *personal action* (or a *representative action*) based on other contracts the member may have with the company or with the body of members (see 'Shareholders' agreements', pp 244ff).

(iii) A *statutory action* permitted by certain specific provisions in CA 2006 (see, eg, the provisions applying to reductions of capital or variation of class rights at 'Permitted reductions of capital', pp 513ff and 'Variation of class rights', pp 563ff).

(iv) A statutory action to remedy '*unfair prejudice*' (CA 2006 s 994) (see 'Unfairly prejudicial conduct of the company's affairs', pp 681ff).

(v) A statutory action to *wind the company up on the just and equitable ground* (IA 1986 s 122(1)(g)) (see 'Compulsory winding up on the "just and equitable" ground', pp 795ff).

It is not necessary to examine all of these options in detail in this chapter. However, it is necessary to be alert to the range of different procedures that are available for remedying **(p. 637)** different forms of maladministration. Where the normal process for pursuing well-recognised legal claims is adopted (as where the *company* sues its directors for *negligence*), then nothing more needs to be added to the earlier discussion of how a company acts (see 'General issues', pp 309ff) and what constitutes directors' negligence (see 'Duty to exercise reasonable care, skill and diligence: CA 2006 s 174', pp 353ff). Similarly, where the company or an individual pursues claims that are based on special statutory rights, it is not necessary to re-examine those special rights described earlier (eg individual member's rights of action based on the statutory contract with the company, or the statutory right to complain about reductions of capital or variation of class rights, see 'Members' personal rights', pp 250ff, 'Permitted reductions of capital', pp 513ff and 'Variation of class rights', pp 563ff). This chapter therefore focuses only on the availability of special rights of access to the court (see company claims in points (iii) and (iv) in the previous list), and special grounds of complaint (see members' claims at point (iv), while point (v) is considered in Chapter 16, along with the other grounds for the winding up of companies) in relation to maladministration.

Some of the issues addressed in this chapter were previously dealt with under quite different common law rules (especially the rule in *Foss v Harbottle* **[13.01]**), now replaced by provisions in CA 2006. Care must therefore be taken in referring to older authorities.

Why is shareholder litigation such a problem?

The practical problem which the law has to deal with in this area is balancing the risk that too little litigation is pursued because the wrongdoers are in control, or that too much litigation is pursued because vexatious individuals are disaffected with the majority-determined status quo. The law must therefore define proper limits to litigation control and majority rule. At the same time, it must be conceded that the general rule *is* majority rule, whether by directors or by members (sometimes, in the latter case, with the added protection of super-majorities, or segregated classes of interest groups), so there is always the likelihood of disaffected dissenting minorities. 'Majority rule' applies not only to decisions to pursue business activities, but also to decisions *not* to pursue

corporate wrongdoers (especially directors). The practice of proper majority rule is therefore especially important in this chapter.

We have already seen that the law normally allows members to treat their rights to vote as an incident of property which they may prima facie exercise for their own advantage (*Peter's American Delicacy Co Ltd v Heath* **[4.26]**). Further, it is established that even the strict fiduciary duties of directors do not go so far as to prohibit them altogether from acting in matters where their own personal interests are affected by what they do as directors (*Mills v Mills* **[7.13]**), still less from voting as they like in their capacity as members (*North-West Transportation Co Ltd v Beatty* **[4.33]**) (although now contrast CA 2006 s 239). The three cases just referred to, and many others, also illustrate the traditional unwillingness of the courts to review matters of commercial judgement or policy, or of internal administration. 'This Court,' said Lord Eldon, 'is not to be required on every Occasion to take the Management of every Playhouse and Brewhouse in the Kingdom'.[3]

The time-honoured and democratic principle of majority rule, backed by these other factors, necessarily means that quite substantial power is placed in the hands of those who control more than half of the votes on the board or at a members' meeting. Indeed, where shares are widely dispersed among a large number of members, comparable power can be **(p. 638)** wielded with command of a good deal less than 51% of the votes.[4] Minority members must, in principle, accept the decisions of the majority and must also acknowledge that the power lawfully enjoyed by their more numerous associates is a fact of business life. In theory it is, of course, open to them to seek to bring about change by the normal democratic processes of persuasion, lobbying, publicity and so on; and it may sometimes be appropriate to argue that members who do not agree with the policy of those in control should sell their shares and invest their money elsewhere. In reality, however, neither of these courses may offer a practical solution. Minority members may not have the resources and will often lack access to the necessary information to mount a successful campaign against those in the seat of power. And in a smaller company there will almost always be no market for their shares: the only available buyers (assuming that they are interested) will probably be the very majority members with whom they are in disagreement, and they are likely to offer only a derisory price.[5]

In such circumstances, frustrated minority members may turn to the law for help. Clearly, the law must provide some remedies to meet those cases in which majority power has been abused. There cannot be power—including the power of control over other people's investments—without corresponding responsibility. But the law has to strike a delicate balance. If it too readily supports the majority and is prepared to condone unfair and wrongful acts and decisions on their part, the minority will be prejudiced and, in a small company, 'locked in' with an unrealisable investment which the majority can exploit to its own advantage. If, on the other hand, too great indulgence is shown to complaining minorities, they will be able to obstruct the company's legitimate business with tiresome requisitions and objections, and exploit their nuisance value.

Both the legislature and the judiciary have made attempts to reconcile the opposing needs and interests of controllers and minorities.

Statutory protection is given to minorities by formalities of various kinds, for example:

(i) requiring a special resolution rather than a simple majority vote in important matters, such as constitutional alterations;
(ii) requiring the court's sanction, in matters like a reduction of capital or scheme of arrangement; and
(iii) giving dissentients a right to apply to the court to have a resolution cancelled, for example in a variation of class rights, and sometimes empowering the court to order, alternatively, that they be bought out.

To balance this, some checks are imposed on the use of these measures by safeguards such as a requirement that dissentients applying to the court must have at least 15% support from their fellows.

Other statutory provisions give members direct access to the courts. Foremost among these are the right to petition to have a company compulsorily wound up (Insolvency Act 1986 (IA 1986) s 124) (see 'Compulsory winding up generally', pp 789ff) and the right to seek relief for 'unfairly prejudicial' conduct (CA 2006 s 994) (see 'Unfairly prejudicial conduct of the company's affairs', pp 681ff).

(p. 639) The judges for their part have also developed rules which are aimed at curbing the abuse of power by

those with control. The directors, for example, are restrained by their fiduciary duties and by the 'bona fide' and 'proper purposes' principles. Majority members, at least in the context of an alteration of articles and a variation of class rights, are also constrained to act bona fide and in the common interest. But apart from these well-recognised (though not necessarily well-defined) limitations, the courts have by and large allowed laissez-faire principles to reign and majority rule to operate unchecked. They have thus avoided putting themselves into the position which so alarmed Lord Eldon, although in earlier chapters we have seen the increasing importance of this means of judicial review (see 'Failure to act for proper purposes', pp 331).

All this aside, it remains true that, at least historically, a significant problem for members seeking to cure maladministration of the company by legal action is that the courts strongly resist hearing such claims. Various reasons are given. These include arguments that members' access to the courts will open the floodgates to a multiplicity of claims; that companies by their nature rely on majority rule, and therefore any disputes should be settled internally, by the general meeting, where majority rule should prevail; and, finally, that the courts cannot be asked to adjudicate on matters of business policy rather than matters of law.

The main judicial instrument by which this policy of non-intervention was maintained was a rule not of substance but of procedure, which all company lawyers know as the rule in *Foss v Harbottle* **[13.01]**. Minority members who complained of a wrong or irregularity may well have found this a formidable, and perhaps an insurmountable, barrier to their quest for justice, even where they had a real and well-founded grievance. The rule attracted criticism from across the Atlantic both because of its complexity[6] and because it is considered unjust to recognise a substantive right but deny a remedy on procedural grounds.[7] The rule is outlined briefly in the following section, given how frequently it is still referred to in litigation, before then turning to the modern common law and statutory rules now enshrined in CA 2006.

The old common law rule in *Foss v Harbottle*

The 'rule in *Foss v Harbottle*'[8] provides that, *subject to certain limited exceptions*:

(i) the proper claimant in an action for a wrong alleged to have been done to the company is the company itself (the '*proper claimant principle*'); and
(ii) if the alleged wrong is a matter which it is competent for the company to settle itself (the '*internal management principle*') or, in the case of an irregularity to ratify or condone by its own internal procedure (the '*irregularity principle*'), then no individual member may bring action.

(p. 640) Notice that the rule has an impact on potential court actions in pursuit of wrongs done to a company *and* wrongs done personally to the members of the company. In both cases the rule restricts litigation by individual members unless they can bring themselves within the exceptions to the rule.

The 2006 statutory amendments now appearing in CA 2006 ss 260ff (providing for statutory derivative actions) only affect claims for wrongs done *to* the company, and even then, only claims for wrongs done *by* directors (s 260(5)). Personal claims by members remain subject to the common law, and in particular to the restrictions in point (ii) of the previous list. Recall the impact of the 'internal management' and 'irregularity' principles in the context of litigating to enforce the s 33 contract: see 'The "indoor management rule"', pp 124ff, and also see Further notes following *Pender v Lushington* **[13.19]**, pp 671ff.

[13.01] Foss v Harbottle (1843) 2 Hare 461 (Chancery Division)

The case was brought by two shareholders in the Victoria Park Co (incorporated by statute) against the company's five directors and others, alleging that the property of the company had been misapplied and wasted and certain mortgages improperly given over the company's property. It asked that the defendants should be held accountable to the company, and also sought the appointment of a receiver. The Vice-Chancellor ruled that it was incompetent for the plaintiffs to bring such proceedings, the sole right to do so being that of the company in its corporate character.

WIGRAM V-C: It was not, nor could it successfully be, argued that it was a matter of course for any

individual members of a corporation thus to assume to themselves the right of suing in the name of the corporation. In law the corporation and the aggregate members of the corporation are not the same thing for purposes like this; and the only question can be whether the facts alleged in this case justify a departure from the rule which, prima facie, would require that the corporation should sue in its own name and in its corporate character or in the name of someone whom the law has appointed to be its representative …

Exceptions to the rule in *Foss v Harbottle*

This ‘proper claimant’ rule, if applied rigorously, would certainly ensure that few wrongs committed by directors would be pursued in the courts. Inevitably, therefore, common law ‘exceptions’ emerged, being instances where members, acting alone or together, were permitted to pursue causes of action vested in the company. The actions were derivative, in that, if successful, the remedy accrued to the company, not to the members taking the action. These exceptions, where shareholders *could* sue, were usually grouped under four heads:[9]

(i) the act complained of is *ultra vires* or illegal;
(ii) the matter is one which could validly be done or sanctioned only by some special majority of members;
(iii) the personal and individual rights of the claimant as a member have been invaded; or
(iv) what has been done amounts to a ‘fraud on the minority’[10] and the wrongdoers are themselves in control of the company.

(p. 641) Of course, it is plain that only the fourth exception in this list is a true exception in litigating to remedy wrongs to the company. In pursuing the limits of this exception, the common law then proceeded to tie itself in knots in determining what constituted wrongdoer control,[11] and what counted as a ‘fraud on the minority’, and in particular whether it concerned types of *wrongs* or types of *decision processes*, or some combination of both.[12] It was therefore a relief for all when the CA 2006 s 260ff was introduced. Some of these same notions still remain relevant, but in the exercise of structured judicial discretion, not by way of binding rule.

It might be asked whether all this effort is necessary. The justification is perhaps best put by Lord Denning, quoted in the following extract in a case even though the statutory rules, not the common law ones, were being applied.

[13.02] 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 **[13.04]**.

LEWISON J:

Derivative claims

73 I should begin by saying a little about derivative claims generally. In the first place the new code [CA 2006 ss 260ff] has replaced the common law derivative action. A derivative claim may ‘only’ be brought under the Act. As section 260(1) makes clear a derivative claim is one in which the cause of action is vested in the company, but where the claim is brought by a member of the company. This reflects the old law in which a derivative action was an exception to the general principle (known as the rule in *Foss v Harbottle* (1843) 2 Hare 461) that where an injury is done to a company only the company may bring proceedings to redress the wrong. Allied to this principle was the principle that whether a company should bring proceedings to redress a wrong was a matter that was to be decided by the company internally; that is to say by its board of directors, or by a majority of its shareholders if dissatisfied by the board’s decision. The court would not second guess a decision made by the company in accordance with its own constitution. The exception to these principles was necessitated where the company’s own constitution could not be properly operated. If the wrongdoers were in control of the company (because they were a majority of the shareholders) they would not in practice vote in favour of taking proceedings against themselves, even though the taking of proceedings would be in the company’s best interests. As Lord Denning MR put it in*Wallersteiner v Moir (No 2)* [1975] QB 373, 390:

> 'It is a fundamental principle of our law that a company is a legal person, with its own corporate identity, separate and distinct from the directors or shareholders, and with its own property rights and interests to which alone it is entitled. If it is defrauded by a wrongdoer, the company itself is the one person to sue for the damage. Such is the rule in *Foss v. Harbottle* (1843) 2 Hare 461. The rule is easy enough to apply when the company is defrauded by outsiders. The company itself is the only person who can sue. Likewise, when it is defrauded by insiders of a minor kind, once again the company is the only person who can sue. But suppose it is defrauded by insiders who control its affairs—by directors who hold a majority of the shares—who then can sue for damages? Those directors are themselves the wrongdoers. If a board meeting is held, they will not authorise the proceedings to be taken by the company against themselves. If a general meeting is called, they will vote down any suggestion that the company should sue them themselves. Yet the company is the one person who is damnified. It is the one person **(p. 642)** who should sue. In one way or another some means must be found for the company to sue. Otherwise the law would fail in its purpose. Injustice would be done without redress.'

74 Lord Denning was clearly contemplating a case in which the company's cause of action was a cause of action against the 'insiders' themselves who would be liable for damages. Indeed that seems to be the usual situation in which derivative actions were allowed to continue. That is why this exception to the rule in *Foss v Harbottle* was often called a 'fraud on the minority'.

The statutory derivative action: CA 2006 ss 260ff

CA 2006 ss 260ff has changed the common law fundamentally, and abolished the rule in *Foss v Harbottle* so far as it applies to litigating for wrongs done to the company. The Act provides a new derivative procedure (supplemented by amended Civil Procedure Rules (CPR)[13]). It sets out what sorts of company claims can be pursued, and when. It provides that derivative claims may *only* be brought under the provisions of CA 2006 (ss 260ff) or in pursuance of a **(p. 643)** court order in 'unfair prejudice' proceedings under CA 2006 s 994 (see 'Unfairly prejudicial conduct of the company's affairs', pp 681ff): CA 2006 s 260(2) (cited in the following section).[14] Its significant invention is that it passes the 'gatekeeper' role in derivative corporate claims to the court, which must exercise a structured discretion on grounds laid out (non-exhaustively) in CA 2006.

The statutory rules

The provisions of CA 2006 Pt 11 deserve close reading.

CA 2006 s 260: Derivative claims

(1) This Chapter applies to proceedings in England and Wales or Northern Ireland by a member of a company—

(a) in respect of a cause of action vested in the company, and
(b) seeking relief on behalf of the company.
This is referred to in this Chapter as a 'derivative claim'.

(2) A derivative claim may only be brought—

(a) under this Chapter, or
(b) in pursuance of an order of the court in proceedings under section 994 (proceedings for protection of members against unfair prejudice).

(3) A derivative claim under this Chapter may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company.
The cause of action may be against the director or another person (or both).

(4) It is immaterial whether the cause of action arose before or after the person seeking to bring or continue the derivative claim became a member of the company.
(5) For the purposes of this Chapter—
  (a) 'director' includes a former director;
  (b) a shadow director is treated as a director; and
  (c) references to a member of a company include a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law.

(p. 644) CA 2006 s 261: Application for permission to continue derivative claim

(1) A member of a company who brings a derivative claim under this Chapter must apply to the court for permission (in Northern Ireland, leave) to continue it.
(2) If it appears to the court that the application and the evidence filed by the applicant in support of it do not disclose a prima facie case for giving permission (or leave), the court—
  (a) must dismiss the application, and
  (b) may make any consequential order it considers appropriate.

(3) If the application is not dismissed under subsection (2), the court—
  (a) may give directions as to the evidence to be provided by the company, and
  (b) may adjourn the proceedings to enable the evidence to be obtained.

(4) On hearing the application, the court may—
  (a) give permission (or leave) to continue the claim on such terms as it thinks fit,
  (b) refuse permission (or leave) and dismiss the claim, or
  (c) adjourn the proceedings on the application and give such directions as it thinks fit.
  [Section 262 defines the exclusive circumstances in which a member can take over, by way of derivative claim, an action commenced by the company.]

CA 2006 s 263: Whether permission to be given

(1) The following provisions have effect where a member of a company applies for permission (in Northern Ireland, leave) under section 261 or 262.
(2) Permission (or leave) must be refused if the court is satisfied—
  (a) that a person acting in accordance with section 172 (duty to promote the success of the company) would not seek to continue the claim, or
  (b) where the cause of action arises from an act or omission that is yet to occur, that the act or omission has been authorised by the company, or
  (c) where the cause of action arises from an act or omission that has already occurred, that the act or omission—
    (i) was authorised by the company before it occurred, or
    (ii) has been ratified by the company since it occurred.

(3) In considering whether to give permission (or leave) the court must take into account, in particular—
  (a) whether the member is acting in good faith in seeking to continue the claim;
  (b) the importance that a person acting in accordance with section 172 (duty to promote the success of the company) would attach to continuing it;
  (c) where the cause of action results from an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—
    (i) authorised by the company before it occurs, or
    (ii) ratified by the company after it occurs;

  (d) where the cause of action arises from an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company;
  (e) whether the company has decided not to pursue the claim;
  (f) whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than on behalf of the company.

(4) In considering whether to give permission (or leave) the court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter.

(p. 645) **(5)** The Secretary of State may by regulations—

(a) amend subsection (2) so as to alter or add to the circumstances in which permission (or leave) is to be refused;

(b) amend subsection (3) so as to alter or add to the matters that the court is required to take into account in considering whether to give permission (or leave).

(6) Before making any such regulations the Secretary of State shall consult such persons as he considers appropriate.

(7) Regulations under this section are subject to affirmative resolution procedure.

[Section 264 defines the conditions under which the court will grant permission to a member to continue a derivative claim brought by another member.]

Grounds for bringing a derivative claim

CA 2006 broadens (but also makes exclusive) the grounds upon which a derivative claim (as defined in s 260(1)) is available to members.[15] Under s 260(3), a cause of action arising from an actual or proposed act or omission *by a director* involving negligence, default, breach of duty or breach of trust are recognised as the only basis upon which to commence such a claim. Perhaps not all the wrongs which a director could conceivably commit against the company are included in the section, but breach of duty includes the newly codified directors' duties examined in Chapter 7, and 'director' for these purposes includes both former directors and shadow directors. Breach of duty presumably also includes other breaches under the Act (beyond the directors' general duties), and breaches of common law duties not within the Act at all.

Provided the cause of action is in respect of a relevant breach by a director, third parties may also be made defendants in the derivative claim, either in lieu of or in addition to the wrongdoing director (s 260(3)). The general rules on third party liability in respect of breaches of duty by the directors are not set out in the Act, but rely on the common law rules on dishonest assistance and knowing receipt ('Secondary liability (liability of third parties associated with directors' wrongs)', pp 451ff).

It does not matter whether the cause of action arose before or after the person seeking to bring the derivative claim became a member (s 260(4)).

➢ Question

If the facts in *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 WLR 2 were to arise now, litigation could not be pursued in derivative form by the members under the CA 2006 rules since the wrong in question was not committed by the directors, but by the majority shareholders voting to break an agreement. How will remedies now be provided in this type of case?

Court permission to continue a derivative claim

General issues

The new statutory provisions oblige a member seeking to bring a derivative claim to apply to the court for permission to continue it (s 261). There are also provisions, which, in specific circumstances, allow a member to continue: (i) as a derivative claim, a proceeding which might appropriately be pursued as such but was initially brought by the company (s 262); or (ii) a derivative claim brought by another member (s 264).

(p. 646) Section 263 lies at the heart of the new procedure. This section sets out the criteria the courts must use in granting permission to members to pursue derivative claims.

Compulsory refusal of permission

Section 263(2) sets out the only three matters that are complete bars to pursuit of a derivative claim (provided, of course, that the claimant's evidence discloses a prima facie case, as required by s 261(2)). Other considerations will, at most, play into the court's exercise of its discretion under s 260(3). The court *must* refuse permission to continue a derivative claim where:

(i) a person acting in accordance with s 172 (ie the duty to promote the success of the company) would not seek to continue the claim (s 263(2)(a)); or
(ii) the proposed conduct constituting the wrongdoing has been authorised by the company (s 263(2)(b)); or
(iii) the wrongdoing has occurred, but was previously authorised or subsequently ratified by the company (s 263(2)(c)).

The action is not designed to promote the success of the company

Section 260(2)(a) reflects the fundamental philosophy of the derivative claim (and, it might be hoped, of the rule in *Foss v Harbottle*): a member ought to be permitted to pursue a derivative claim *because* this is for the benefit of the company, not because this is for the benefit of the member personally.[16] But the test that must be applied by the court is not quite as tough as this. The court does not have to decide whether a hypothetical director (subject to the duty in s 172) *would* think the claim worth pursuing (although that is relevant under s 263(3)(b)); the court merely has to refuse permission if it considers (on the balance of probabilities, presumably) that such a director would*not* seek to continue the claim. It remains to be seen whether the courts will use this power simply to order refusal in cases that are patently not in the company's interest, or whether it will engage in more 'commercial' deliberations, and order refusal in cases that it considers, on a more finely tuned balance, are not in the company's interests.

Proper authorisation or ratification

Section 263(2)(b) and (c) follows logically from the fundamental philosophy outlined previously: if an act has been *properly* authorised or ratified, then it no longer constitutes a wrong to the company, and the company cannot pursue a claim in relation to it, either through a derivative claim or otherwise.

The issue of proper authorisation and ratification is thus brought centre stage. This is a difficult and controversial area of law.[17] CA 2006 makes some specific provisions (see especially ss 175 and 180 on authorisation and s 239 on ratification), and, crucially, both ss 175 and 239 indicate that the votes of the 'wrongdoers' are not to count in determining the outcome in the decision-making body (the board of directors and the general meeting, respectively). This provides welcome clarification in an area where there has been great uncertainty.[18] These sections impose further requirements. Beyond that, however, the common law rules are preserved (see ss 180(4) and 239(7)), with all their complications and **(p. 647)** uncertainties. In particular, the question of whether the particular wrongs committed by the directors *can* be authorised[19] or ratified[20] remains a live issue.[21]

Discretionary refusal of permission

If the court does not refuse permission to continue the derivative action under s 263(2), then it must exercise its discretion in deciding whether to grant permission to the member to continue with the derivative claim. In exercising this discretion, the court *must* take into account, 'in particular' the non-exclusive list of matters provided in s 263(3) (see 'CA 2006 s 263: Whether permission to be given', p 644).

In addition, s 263(4) requires the court to have 'particular regard' to any evidence of the views of members of the company who have no direct or indirect personal interest in the matter. This effectively adopts the *Smith v Croft (No 2)* **[13.17]** test.

Section 263 has now been considered in a range of recent cases which give some indication as to the approach the courts may take to an application for permission to continue a derivative claim: see later for selected extracts.

'Multiple' derivative claims?

The statutory definition of the derivative claim in CA 2006 s 260(1) requires that the proceedings be brought 'by a member of a company … in respect of a cause of action vested in the company'. This seems to exclude 'multiple' derivative claims. This is the common but rather uninformative term for proceedings which are brought not by a member of the wronged company, but by a member of a member of the wronged company—typically, a member of the parent company of a wronged subsidiary or sub-subsidiary. The arguments for allowing such a claim are the same as those for allowing any derivative claim, that is, that the wrong to the subsidiary will go unredressed because neither the board of directors of the subsidiary nor its shareholders (the parent company) will sue.

As was explained by Lord Millett in the Hong Kong Court of Final Appeal in *Waddington Ltd v Chan Choo Hoo Thomas* [2009] 2 BCLC 82, such claims were permitted at common law, although without full analysis and justification (see, eg, *Wallersteiner v Moir (No 2)* [1974] 1 WLR 991). The Company Law Review (CLR) Steering Group recommended that these multiple derivative actions be brought within the statutory scheme (see *Developing the Framework* (2000), para 4.133), but this was not done. A very restrictive construction of s 260(1) and (2) would mean that such actions could not be brought either under the Act or at common law.[22] In *Re Fort Gilkicker Ltd* [2013] EWHC 348 (Ch), Briggs J regarded that conclusion as 'unpalatable', and devised a way around it. He said:

> 34 In my view, neither interpretation [of the Act] produces a result which is so obviously more satisfactory than the other for it to be safe on that ground alone to conclude that Parliament must have intended it. As will appear, a main purpose of the codification of derivative claims in Chapter 1 was to remove what were regarded (at least by the Law Commission in its report on shareholder remedies) as complicated, unwieldy and obscure provisions of the applicable common law and to **(p. 648)** replace them with a clear and transparent code. A conclusion that what Parliament in fact achieved in 2006 was to place a statutory code for derivative claims by members of the wronged company alongside a continued obscure, complicated and unwieldy common law regime for derivative claims by others does not commend itself as an exercise in commonsense. Conversely, a conclusion that by narrowly defining *locus standi* for all company derivative claims to members of the wronged company Parliament abolished a convenient procedural device for doing justice in cases of wrong-doer control, in a modern context where multi-layered corporate structures with holding companies and subsidiaries are ever more common, hardly commends itself as an exercise in justice. There is, on the face of it, no persuasive reason why Parliament should have wished to provide a statutory scheme for doing justice where a company is in wrongdoer control, but none where its holding company is in the same wrongdoer control.
>
> 35 Neither counsel nor I can think of any third construction which would avoid all those unpalatable consequences. It might have been tempting to construe 'member of a company' in section 260(1) as including member of its holding company, but the express and inadequately narrow widening of the ordinary meaning of member in sub-section (5)(c) makes that impossible.
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> …
>
> 44 I have come on balance to the conclusion that the 2006 Act did not do away with the multiple derivative action. My reasons follow. First, there was before 2006 a common law procedural device called the derivative action by which the court could permit a person or persons with the closest sufficient interest to litigate on behalf of a company by seeking for the company relief in respect of a cause of action vested in it. Those persons would usually be a minority of the company's members, but might, if the company was wholly owned by another company, be a minority of the holding company's members. These were not separate derivative actions, but simply examples of the efficient application of the procedural device, designed to avoid injustice, to different factual circumstances.
>
> 45 In 2006 Parliament identified the main version of that device, namely where *locus standi* is accorded to the wronged company's members, labelled it a 'derivative claim' and enacted a comprehensive statutory code in relation to it. As a matter of language, section 260 applied Chapter 1 of Part 11 only to that part of the old common law device thus labelled, leaving other instances of its application unaffected.
>
> 46 Applying the well established relevant principle of construction, Parliament did not expressly abolish the

whole of the common law derivative action in relation to companies, even though by implication from the comprehensiveness of the statutory code it did do so in relation to derivative claims by members (as defined) of the wronged company. Beyond that, the assertion that the remainder of the common law device was abolished fails because abolition was neither express nor a clear or necessary implication.

47 Section 260 could so easily have been phrased to achieve precisely that result. Sub-section (1) could have excluded the phrase 'by a member of a company' and re-introduced it in sub-section (2) as a specific additional requirement in sub-sub-section (a) so that it read 'under this Chapter by a member of the company'. Alternatively, the whole of the common law derivative action in relation to companies could expressly have been abolished, as it was, for example, by section 236(3) of the Australian Corporations Act 2001 which provides that:

> 'The right of a person at general law to bring, or to intervene in, proceedings on behalf of the company is abolished.'

48 Neither Lord Millett nor any of the other academic writers who have concluded that the 2006 Act abolished multiple derivative actions have addressed the simple point of construction advanced by Mr Lightman, Mr Hollington QC and by Mr Bailey in the present case, and it may be assumed that the editors of Palmer must have applied the same or a similar analysis.

49 I reach this conclusion with some relief. Not only does it address the manifest scope for real injustice which the abolition of any derivative action by members of a holding company would have entailed, and as graphically described by Lord Millett in his article, but it ensures that English company law runs in this respect in harmony with the laws of Hong Kong, Singapore, Canada, Australia **(p. 649)** and New Zealand, all of which have, albeit by different methods, ensured that injustice of the type described by Lord Millett can properly be addressed.

➢ Questions

1. Is the order of the list in s 263(3) significant? In particular, is it significant that the views of the 'hypothetical director' are not given greater prominence?

2. Does segregation of s 263(4) from the list of issues provided in s 263(3) indicate that the views of disinterested members should have *more* or *less* influence than the other matters on the court's decision?

3. Is an agreed hierarchy of discretionary considerations essential? What is a court likely to do if, for example, the member is *not* acting in good faith, but a 'hypothetical director' *would* think the claim likely to promote the success of the company?

4. Do the common law cases suggest additional factors that might be relevant to exercise of the court's discretion? In particular, what has happened to the idea of 'control' of the company by the wrongdoers?

5. Are you persuaded by the reasoning of Briggs J in *Re Fort Gilkicker Ltd*, cited in the previous extract?

The consequences of the new statutory derivative action are difficult to predict. Much will depend on how willing the courts will be to intervene in a company's decision-making processes. On the one hand, the traditional reluctance of the courts to intervene, and experience of codification of derivative actions from other jurisdictions, suggest that a wild proliferation in the number of derivative claims allowed to proceed is unlikely. On the other hand, the expanded breadth of grounds upon which a derivative claim may be based, combined with new statutory expressions of directors' duties, are likely to make it easier for activist or aggrieved members to initiate a derivative

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