(see ‘Receivership generally’, pp 778ff), so the secured creditor here had a primary entitlement to obtain and retain all damages awarded for the breaches of duty, whereas the unsecured creditor’s prejudice arose only through the depletion of the assets of the company. The court was also persuaded by policy considerations, recognising that invoking the reflective loss principle would have the deleterious effect of denying the secured creditor his right to pursue his claims directly and under his own control.

Unfairly prejudicial conduct of the company’s affairs

So far in this chapter the focus has been on maladministration that constitutes a legal wrong, either to the company itself or to its members. CA 2006 ss 994ff give the court, on the application of a member, a wide-ranging power to remedy conduct of a company’s affairs that is ‘unfairly prejudicial to the interests of members generally or to some part of its members’.[38] The most **(p. 682)** common complaint is that a controlling majority has acted in a manner that is ‘unfairly prejudicial’ (the meaning of this term is explored later). The most common remedy sought is an order that the majority purchase the minority’s shares at a price that reflects their proportion of the company’s value. This is despite s 996(1), which gives the court the power to make ‘such order as it thinks fit’, with s 996(2) merely providing examples of possible orders, including compulsory share purchases. Most of the cases concern ‘quasi-partnerships’, although the provision has general application.

➤ Note

By way of linking the previous section on derivative claims to this one on ‘unfair prejudice’, note Lewison J in *Iesini v Westrip Holdings Ltd* (facts at **[13.10]**):

> 81 In parallel with a derivative action, there was (and is) the possibility of bringing a petition for unfair prejudice. This procedure is now governed by section 994 of the Companies Act 2006. The relief which the court may give under section 996 is very wide-ranging (‘such order as it thinks fit’); but the section specifically provides that the court may require the company to do an act that the petitioner has complained that it has omitted to do; or authorise civil procee dings to be brought in the name and on behalf of the company by such person or persons and on such terms as it may direct. If a petition is brought the court will decide (on the balance of probabilities) in the course of the petition whether the affairs of the company have been conducted in a manner unfairly prejudicial to the petitioner. It is only if the court has decided that they have that it will go on to consider the appropriate relief. It will be noted that section 260(1) contains a general definition of ‘derivative claim’ and section 260(2) envisages two different ways in which such a claim may be brought. One is ‘under this Chapter’, in which case the restriction on the permissible cause of action contained in section 260(3) applies (‘A derivative claim *under this Chapter* may only be brought …’). The other is pursuant to an order made in proceedings under section 994, in which case the restrictions in section 260(3) do not apply. In that case, the general definition in section 260(1) is the only relevant definition of a derivative claim.
>
> 82 Accordingly it seems to me that where the petitioner’s complaint is that the company has failed to assert a good claim against a third party the court’s powers under section 996 would include the making of an order requiring the company to assert that claim, if necessary by taking or defending proceedings. Since the company’s claim would be a claim against a third party, once the court had decided that a failure to assert that claim had unfairly prejudiced the petitioner, the directors would not need to be parties to the subsequent claim against the third party. In addition the width of the court’s jurisdiction under section 996 enables the joinder of third parties to the petition itself, at least where relief is claimed against them: *Re Little Olympian Each-Ways Ltd* [1994] 2 BCLC 420; *Lowe v Fahey* [1996] 1 BCLC 262.
>
> 83 On the other hand, it may be that the company’s cause of action is a cause of action only against the directors for loss suffered as a result of their default or breach of duty (etc.). In such a case the directors will be necessary parties to the company’s claim. It may be, therefore, that different procedural routes will be

adopted depending on the company's underlying claim.

The scope of CA 2006 s 994

CA 2006 s 994 repeats CA 1985 s 459, so the doctrinal and practical learning on the earlier provision remains relevant. Indeed, some of the cases on the initial provision (Companies Act 1948 (CA 1948) s 210), which provided remedies for 'oppression' rather than unfair prejudice, are still considered influential.

(p. 683) CA 1985 s 459 was a popular provision, not least because the courts adopted a purposive approach and interpreted the section liberally where necessary in order not to stultify its development. Moreover, by its very terms the section clearly aimed to address management problems ranging well beyond traditional legal wrongs done to a company or its shareholders. But this popularity created problems of its own. The courts were required to handle large numbers of cases, each often demanding the hearing of a great deal of evidence and examination of the conduct of the parties, sometimes going back over many years. This caused costs to escalate, even though most cases concerned relatively small companies, where costs of full High Court hearings are discouraging, if not entirely prohibitive.[39]

In the light of these factors, there were frequent calls for reform (not least from the judges themselves). Both the Law Commissions and the CLR examined CA 1985 s 459 and proposed possible reforms.[40] The Law Commissions recommended that the excessive length and cost of many CA 1985 s 459 proceedings should be dealt with primarily by active case management by the courts. This happened. They also recommended encouraging the use of alternative dispute resolution procedures. Their other recommendations (not so far adopted) included:

(i) making legislative provision for a statutory buy-out remedy (at a price reckoned on a pro rata and not a discounted basis) where a member of a private company with a shareholding of at least 10% has been excluded from participation in management, coupled with a presumption in such cases that the expulsion was unfairly prejudicial. Since research shows that the most common s 459 application is made in this kind of case, and that a buy-out is invariably ordered if the claimant is successful, it seems likely that a rule along these lines would lead to many cases being settled out of court;
(ii) providing a time limit for bringing s 459 claims, to stop so much past history being put before the court;
(iii) adding a winding-up remedy to the remedies available under s 459 (but also providing that an application to seek this remedy should require the leave of the court);[41]
(iv) prohibiting advertisement (ie publicity) of s 459 proceedings, unless the court orders otherwise; and
(v) encouraging the use of 'shareholder's exit' articles in the constitutions of private companies (ie articles which settle in advance the terms on which members will leave the company in the event of future disputes), and providing such an article in the Model Articles for private companies.

The CLR gave these suggestions a cool reception, and expressly opposed recommendations (i) and (iii). It did, however, put forward one suggestion which features in the law of some other countries, but would be a novelty here: that is, that s 459 should apply not only to the abuse of power by a majority, but also to cases where a *minority* exercises its powers to block **(p. 684)** company decisions—for example, where it improperly prevents the passing of a special resolution which is demonstrably in the best interests of the company. As matters have emerged, CA 2006 has not taken up any of these suggestions, and CA 2006 s 994 adopts precisely the same form as CA 1985 s 459.

Although an enormous number of decisions are reported every year, not many repay prolonged study. Since the remedy is at the court's discretion, and depends upon the facts, there is often a lengthy account of all the evidence given in the case, but little chance of finding statements of principle of any significance. Included here are extracts from the few leading cases, and from a further selection of illustrative cases.

Nominee directors and conflicts that amount to 'oppression'.

[13.24] Scottish Co-operative Wholesale Society Ltd v Meyer [1959] AC 324 (House of Lords)

[This case was decided under the old CA 1948 s 210 'oppression' section, but is still regarded as influential. Despite the differences in the wording of CA 2006 ss 994 and 210, there can be little doubt that the same conclusion would be reached today.]

Scottish Textile & Manufacturing Co Ltd was a private company formed in 1946 by the appellant society and the respondents, Meyer and Lucas, to manufacture rayon cloth at a time when this product was subject to a system of state licensing. The society held the majority of the issued shares and had appointed three of its own directors to the board; the respondents, who held the rest of the shares, were joint managing directors and as such filled the remaining seats on the board. The society had formed this subsidiary because it could not have secured a licence to produce rayon cloth without experienced managers, and the respondents had the necessary experience. After licensing ceased in 1952, the society, by transferring the company's business to another branch of its organisation and cutting off the supply of raw materials on which the company was dependent, caused its activities to come to a standstill, with the result that it made no profits and the value of its shares fell greatly. The respondents petitioned for relief under s 210, and the House of Lords, confirming the decision of the Court of Session, ordered the society to purchase their shares at a fair price.

LORD DENNING discussed the facts, and continued: Such being 'the matters complained of' by Dr Meyer and Mr Lucas, it is said: 'Those are all complaints about the conduct of the co-operative society. How do they touch the real issue—the manner in which the affairs of the textile company were being conducted?' The answer is, I think, by their impact on the nominee directors. It must be remembered that we are here concerned with the manner in which the affairs of the textile company were being conducted. That is, with the conduct of those in control of its affairs. They may be some of the directors themselves, or, behind them, a group of shareholders who nominated those directors or whose interests those directors serve. If those persons—the nominee directors or the shareholders behind them—conduct the affairs of the company in a manner oppressive to the other shareholders, the court can intervene to bring an end to the oppression.

What, then, is the position of the nominee directors here? Under the articles of association of the textile company the co-operative society was entitled to nominate three out of the five directors, and it did so. It nominated three of its own directors and they held office, as the articles said, 'as nominees' of the co-operative society. These three were therefore at one and the same time directors of the co-operative society—being three out of twelve of that company—and also directors of the textile company—three out of five there. So long as the interests of all concerned were in harmony, there was no difficulty. The nominee directors could do their duty by both companies without embarrassment. But, so soon as the interests of the two companies were in conflict, the nominee directors were placed in an impossible position. It is plain that, in the circumstances, these three **(p. 685)** gentlemen could not do their duty by both companies, and they did not do so. They put their duty to the co-operative society above their duty to the textile company in this sense, at least, that they did nothing to defend the interests of the textile company against the conduct of the co-operative society. They probably thought that 'as nominees' of the co-operative society their first duty was to the co-operative society. In this they were wrong. By subordinating the interests of the textile company to those of the co-operative society, they conducted the affairs of the textile company in a manner oppressive to the other shareholders.

It is said that these three directors were at most only guilty of inaction—of doing nothing to protect the textile company. But the affairs of a company can, in my opinion, be conducted oppressively by the directors doing nothing to defend its interests when they ought to do something—just as they can conduct its affairs oppressively by doing something injurious to its interests when they ought not to do it …

Your Lordships were referred to *Bell v Lever Bros Ltd*,[42] where Lord Blanesburgh said that a director of one company was at liberty to become a director also of a rival company. That may have been so at that time. But it is at the risk now of an application under s 210 if he subordinates the interests of the one company to those of the other.

So I would hold that the affairs of the textile company were being conducted in a manner oppressive to Dr Meyer and Mr Lucas …

One of the most useful orders mentioned in the section—which will enable the court to do justice to the injured shareholders—is to order the oppressor to buy their shares at a fair price: and a fair price would be, I think, the value which the shares would have had at the date of the petition, if there had been no oppression …

VISCOUNT SIMONS and LORDS MORTON OF HENRYTON and KEITH OF AVONHOLM delivered concurring opinions.

➢ Note

The 'most useful' remedy of compulsory buy-out at a fair price, recognised in the extract, has become almost the only remedy called upon in these cases. *Re HR Harmer Ltd* [1959] 1 WLR 62, CA, remains notable for a more imaginative approach. The trial judge found that an autocratic father, in his role as 'governing director', was behaving 'oppressively'. He granted the sons relief, ordering, inter alia, 'that the company should contract for the services of the father as philatelic consultant at a named salary, that the father should not interfere in the affairs of the company otherwise than in accordance with the valid decision of the board of directors, and that he should be appointed president of the company for life, but that this office should not impose any duties or rights or powers'. The order was upheld by the Court of Appeal.

Unfair prejudice in the conduct of the affairs of a subsidiary will suffice.

[13.25] Re City Branch Group Ltd [2005] 1 WLR 3505 (Court of Appeal)

This case was decided under CA 1985 s 459, and provides a modern example of what may constitute 'unfairly prejudicial' conduct. R and G each held 50% of the shares in a company, C. C had three wholly owned subsidiaries. All the business of C, which involved investment property portfolios, was carried out through its subsidiaries. C's business was effectively a quasi-partnership between R and G, which broke down following differences between them. R had applied for C to be wound up on the 'just and equitable' ground (see 'Compulsory winding up on the "just and equitable" ground', pp 795ff), and G had sought an order under **(p. 686)** CA 1985 s 459 on the ground that C's affairs had been conducted in a manner unfairly prejudicial to the interests of C, citing breaches of fiduciary duty and misappropriation of funds by R in respect of two of C's subsidiaries. On appeal, R argued that his alleged conduct related solely to C's subsidiaries and not to C itself, and therefore the petition could not succeed in relation to C. The Court of Appeal, dismissing the appeal, held that 'the affairs of the company' (in s 459) had a broad application and could include the affairs of a subsidiary, particularly as in the instant case where the directors of the holding company and the subsidiary were substantially the same.

SIR MARTIN NOURSE:… I now come to the main question. Does the court have power to make an order under section 459 in relation to a holding company where, first, it is the affairs of its wholly-owned subsidiary that are being or have been conducted in an unfairly prejudicial manner and, secondly, the directors of the holding company are also directors of the subsidiary? I emphasise that here Mr Gross and Mr Rackind are the only directors of the company and of Blaneland and are also directors of Citybranch, of which Mr Gerald Gross is an additional director.

There is no English authority which directly answers this question. … [He then examined various potentially relevant authorities, and continued:] [These observations] demonstrate that the expression 'the affairs of the company' is one of the widest import which can include the affairs of a subsidiary. Equally, I would hold that the affairs of a subsidiary can also be the affairs of its holding company, especially where, as here, the directors of the holding company, which necessarily controls the affairs of the subsidiary, also represent a majority of the directors of the subsidiary. (In the case of Blaneland they are identical). … [He then examined various Australian authorities, and continued:]

… The decision in *In re Norvabron (No 2)*[43] was followed and applied by Powell J, sitting in the Equity Division of the Supreme Court of New South Wales, in *In re Dernacourt Investments Pty Ltd* (1990) 2 ACSR 553… It was held that the conduct of the affairs of the holding company towards a subsidiary may constitute the conduct of the affairs of the subsidiary and vice versa. Powell J said, at p 556:

> '8. The words "affairs of the company" are extremely wide and should be construed liberally: (a) in determining the ambit of the "affairs" of a parent company for the purposes of section 320 [the equivalent of CA 1985 s 459], the court looks at the business realities of a situation and does not confine them to a narrow legalistic view; (b) "affairs" of a company encompass all matters which may come before its board for consideration; (c) conduct of the "affairs" of a parent company includes refraining from procuring a subsidiary to do something or condoning by inaction an act of a subsidiary, particularly when the directors of the parent and the subsidiary are the same.' (Reference was there made to three authorities including *In re Norvabron (No 2)*.)

Powell J said, at p 561:

> 'although the relevant plaintiff must demonstrate that it is the relevant company's affairs which are being so conducted, I am prepared to proceed upon the bases, first, that, in an appropriate case, the conduct of a holding company, or of such of its directors who happen to be directors of the relevant subsidiary, towards a subsidiary, may constitute conduct in the affairs of that subsidiary (*Scottish Cooperative Wholesale Society Ltd v Meyer* **[13.24]**), and, secondly, that, in an appropriate case, the conduct of a subsidiary, or of some or all of its directors who happen as well to be directors of the holding company, may be regarded as part of the conduct of the affairs of the holding company: *In re Norvabron Pty Ltd (No 2)* 11 ACLR 279.'

In my view the second basis identified by Powell J, following and applying the decision in *In re Norvabron (No 2)*, is of great value in the decision of the present case. I accept that decisions of **(p. 687)** courts in other Commonwealth countries are of persuasive value only. But those two decisions certainly persuade me that the view taken by Judge Weeks QC, without their assistance, was correct … Those were considered judgments of judges of the Supreme Courts of Queensland and New South Wales respectively and they are directly in point. I would follow them accordingly. …

KEENE and JACOB LJJ concurred.

Basic principles

A very large number of cases have been reported under CA 1985 s 459 (the predecessor to CA 2006 s 994). However, (no doubt out of a concern to save costs) many of them are rulings on preliminary points of law or on applications to strike out the proceedings, dealing with isolated issues, so that it is possible to identify the principles which are emerging only after fairly wide reading of the reports. But certain points as summarised in the following sections are now regarded as reasonably well settled. These principles can be assumed also to apply in full to CA 2006 s 994, since the wording is identical.

Who may apply

CA 2006 s 994 allows applications to court from:

(i) a member (s 994(1), as defined in CA 2006 s 112), or members, including nominee shareholders,[44] not necessarily constituting a numerical minority,[45] but not holding a voting majority;[46]
(ii) a person to whom shares have been 'transmitted by operation of law' (s 994(2)), such as a trustee in bankruptcy or the personal representative of a deceased member: these people can apply even though they

are not registered as members; but 'transmitted by operation of law' does not include persons holding by way of constructive trust (*Re a Company (No 007828 of 1985)* (1985) 2 BCC 98,951);
(iii) a person to whom shares have been 'transferred' (s 994(2)): these people can apply even though they are not registered as members, but the cases have drawn a line indicating that mere agreement to transfer will not suffice; there must be a proper instrument of transfer executed and delivered to either the transferee or the company (*Re Quickdome Ltd* [1988] BCLC 370; *Re McCarthy Surfacing Ltd* [2006] EWHC 832 (Ch); *Re Zetnet Ltd* [2011] EWHC 1518 (Ch)); or
(iv) the Secretary of State (s 995).

But a former member has no standing to apply, even if the conduct complained of occurred while he or she was a member (*Re a Company* [1986] 2 All ER 253). On the other hand, members (and presumably others) *with* standing can rely on conduct that pre-dates their registration as shareholders (*Lloyd v Casey* [2002] 1 BCLC 454).

Petitioners seeking relief need not 'come with clean hands', although their conduct may be relevant in deciding whether relief should be granted and what the nature of such relief should be: *Re London School of Electronics Ltd* [1986] Ch 211. In *Shah v Shah* [2010] EWHC 313 (Ch), for example, the petitioner 'clearly misconducted himself as employee', yet the learned judge nonetheless found that his attitude to the overall management of the company could not justify his exclusion [115]. In *Re Tobian Properties Ltd* [2012] EWCA Civ 998, the lower court had refused an unfair prejudice petition on the basis that the alleged wrongdoing had **(p. 688)** been disclosed in the company's accounts (available at Companies House). Arden LJ (with whom Aikens and Kitchin LJJ concurred) reversed the lower court's ruling, holding that this requirement was wrong in principle, as it would impose a new restriction on shareholders, namely that they would be at risk of losing their rights to protect their interests as minority shareholders if they failed to read filed accounts properly.

Although most s 459 petitions have been brought by shareholders in private companies, the jurisdiction does not exclude public companies from its scope. The same trend is likely with CA 2006 s 994 petitions.

Respondents

Normally, the respondents are the controlling members and/or directors. If the company is made a party, this is usually on a nominal basis. Several cases have held that it is improper for the controllers to use the company's funds to fight their case (see, eg, *Re a Company, ex p Johnson* [1992] BCLC 701).

Orders can, however, be sought against more remote respondents. In *Re Little Olympian Each-Ways Ltd (No 3)* [1995] 1 BCLC 636, the company's assets had been sold at an undervalue by those in *de facto* control to another company which was also controlled by them. It was held that an order could be made against the *second* company requiring it to buy out the petitioner's shares at a price which reflected their value before the wrongful sale.

And in *Re a Company* [1986] 1 WLR 281, Hoffmann J ruled that an order could be made against a former member, so ensuring that a potential respondent cannot escape liability by transferring his shares away before proceedings are commenced.

In *F&C Alternative Investments (Holdings) Ltd v Francois Barthelemy, Anthony Culligan* [2011] EWHC 1731 (Ch) at [1096], Sales J said the following:

> What is the relevant test of attribution of responsibility beyond the narrow class of case where an agency relationship exists? In my judgment, the test is whether the defendant in a s 994 claim is so connected to the unfairly prejudicial conduct in question that it would be just, in the context of the statutory regime contained in ss 994 to 996, to grant a remedy against that defendant in relation to that conduct. The standard of justice to be applied reflects the requirements of fair commercial dealing inherent in the statutory regime. This is to state the test at a high level of abstraction. In practice, everything will depend upon the facts of a particular case and the court's assessment whether what was done involved unfairness in which the relevant defendant was sufficiently implicated to warrant relief being granted against him.

(This decision was later reversed by the Court of Appeal, but on a separate issue.)

Procedure

Since the introduction of the CPR, courts have started to take a much more vigorous and proactive stance (see, eg, *Re Rotadata Ltd* [2000] 1 BCLC 122). The Rules require the court to take the initiative from the outset and manage cases actively. The court registrar is required to consult the parties with a view to narrowing the issues, to consider bringing in outside experts and/or conciliators, etc, so as to minimise the length of any court hearing and cut down costs. The litigants are reminded that it is their duty to cooperate and to agree as much as possible on the issues in a constructive and sensible way. Recently, in *Re Tobian Properties Ltd* [2012] EWCA Civ 998, CA, at [27], Arden LJ made the following comments in relation to effective case management in s 994 proceedings:

> Unfair prejudice proceedings generally raise numerous factual issues entailing examination of events over a considerable period of time. Just as defended divorces used to raise numerous issues, making trials long and complex, so trials of s 994 petitions can be long and complex. Thus a high degree of case management is required if the case is not to get out of hand. Effective case **(p. 689)** management means that, where possible, the court prevents unnecessary court time being spent on issues that are not capable of giving rise to relief. Thus a court will generally determine the issues necessary to determine whether a buyout order should be made at one hearing ('the liability hearing') and only proceed to a second hearing ('the quantum hearing'), at which evidence would be given relevant to establishing the value of the petitioner's shares, once it has determined that a buyout order should be made. Case management, however, must be consistent with both parties' right to a fair hearing.

In this area, combined claims can cause special problems. In particular, it is possible for a complaint under s 994 and an application for winding up[47] to be combined in the same petition. Since there are several reported cases in which a member has failed on the former ground but succeeded on the latter, judges could hardly complain when this became more or less standard practice. But since the presentation of a petition for winding up is likely to attract unfavourable publicity (and lead almost invariably to the freezing of the company's bank account), so putting considerable pressure on the controllers, this may give a minority shareholder an unfair bargaining advantage. In an attempt to counter this, Practice Direction [1999] BCC 741, para 9, requires petitioners to seek a winding-up order only where this is genuinely considered appropriate and, where they do, to consent to a standard-form interim order which enables the company to continue to trade and use its bank account pending the hearing of the case.

In *Re Abbington Hotel Ltd* [2012] 1 BCLC 410, an unfair prejudice claim was brought by the petitioner, while the respondent concurrently brought a cross-claim of unfair prejudice against the petitioner. David Richards J was satisfied that both petitions established a case of unfairly prejudicial conduct of the company's affairs, and therefore ordered that relief be granted and one party was ordered to buy out the 50% holding of the other. This is a good example of effective case management where both complaints were disposed of in the course of one set of proceedings, especially where there was considerable overlap between the two claims.

Grounds

CA 2006 s 994 requires the petitioner to show that 'the *company's affairs* are being or have been conducted in a manner that is *unfairly prejudicial* to the *interests of members* generally or of some part of its members …' (s 994(1)(a)); or that 'an actual or proposed act or omission of the company … is or would be so prejudicial' (s 994(1)(b)). Each of the highlighted requirements has proved troublesome.

Meaning of 'the company's affairs'

The complaint must be about the conduct of the company's affairs, not the conduct of the affairs a member or director in a private capacity. So, in *Re Unisoft Group Ltd (No 3)* [1994] 1 BCLC 609, and again in *Re Leeds United Holdings plc* [1996] 2 BCLC 545, relief under s 459 was refused where the respondent was alleged not to have honoured a shareholders' agreement relating to the transfer of shares. But the leading case of *Scottish Wholesale Co-operative Society Ltd v Meyer* **[13.24]** shows that a broad view may also be taken of this requirement. And

in *Re City Branch Group Ltd* **[13.25]**, it was held that 'the affairs of the company' could be interpreted widely, and could extend to the affairs of a subsidiary company, especially where, as in that case, the directors of the holding company and the subsidiary were almost identical. In *Re Abbington Hotel Ltd* [2012] 1 BCLC 410, it was held that the completion of the false minute by the respondent director seeking to agree a sale of the company, and in the hope of **(p. 690)** persuading the company's solicitor that he was acting with authority, occurred in the course of his conduct, albeit wrongful, of the company's affairs.

➢ Question

Consider the recent case of *Re Home & Office Fire Extinguishers Ltd* [2012] EWHC 917 (Ch). HHJ Strauss QC found that a director/shareholder's physical attack on his brother/co-shareholder was part of the conduct of the company's affairs, not the conduct of the affairs of the director/shareholder in his private capacity. This was because it constituted a breach of the implied understanding that the two brothers would act properly and in good faith towards each other. Further, the attack was a single event which made it impossible for them to continue their association as directors of, and shareholders in, the company; and that the attack arose as a reaction to the petitioner brother's refusal to lend money to the respondent (ie a decision concerning the company's finances). Are you persuaded by such a broad interpretation of 'company's affairs'? Is it true that most acts complained of in s 994 clams are 'personal' (even if not physical), and they make it impossible for shareholders to continue their association, which is why a s 994 petition is brought in most cases?

Meaning of 'unfairly prejudicial'

The conduct complained of must be both unfair *and* prejudicial, not merely unfair (*Re Saul D Harrison & Sons plc* **[13.29]**; *Rock Nominees Ltd v RCO* [2004] 1 BCLC 439), nor merely prejudicial (*Re London School of Electronics Ltd* [1986] Ch 211; *Nicholas v Soundcraft Electronics Ltd* ('Examples of "unfairly prejudicial" conduct', pp 697ff)).

The courts also stress that unfairly prejudicial conduct and wrongful or illegal conduct are separate concepts, each leading to its own remedies (*Re Charnley Davies Ltd*[1990] BCLC 760).

The test is objective, so the emphasis is not so much on the motive or intention of the controllers, as on the effect that the conduct has had on the complaining member (*Re Sam Weller & Sons Ltd* [1990] Ch 682). In *Re Guidezone Ltd* [2000] 2 BCLC 321 at 355, Jonathan Parker J said that *O'Neill v Phillips* **[13.30]** established that:

> 'unfairness' for the purposes of s 459 is not to be judged by reference to subjective notions of fairness, but rather by testing whether, applying established equitable principles, the majority has acted, or is proposing to act, in a manner which equity would regard as contrary to good faith.

In similar vein, Arden LJ in *Re Tobian Properties Ltd* [2012] EWCA Civ 998, CA, explained 'fairness' in this context as being 'flexible and open-textured but it is not unbounded. The courts must act on a principled basis even though the concept is to be approached flexibly. They cannot decide whether to grant or refuse relief from unfair prejudice on the basis of palm-tree justice'.

Further guidance on the meaning of 'prejudice' can be found in the following judgment of David Richards J in *Re Coroin Ltd* [2012] EWHC 2343 (Ch):

> 630 Prejudice will certainly encompass damage to the financial position of a member. The prejudice may be damage to the value of his shares but may also extend to other financial damage which in the circumstances of the case is bound up with his position as a member … The prejudice must be to the petitioner in his capacity as a member but this is not to be strictly confined to damage to the value of his

shareholding. Moreover, prejudice need not be financial in character. A disregard of the rights of a member as such, without any financial consequences, may amount to prejudice falling within the section.

631 Where the acts complained of have no adverse financial consequence, it may be more difficult to establish relevant prejudice. This may particularly be the case where the acts or **(p. 691)** omissions are breaches of duty owed to the company rather than to shareholders individually. If it is said that the directors or some of them had been in breach of duty to the company but no loss to the company has resulted, the company would not have a claim against those directors. It may therefore be difficult for a shareholder to show that nonetheless as a member he has suffered prejudice …

Examples are given at 'Examples of "unfairly prejudicial" conduct', pp 697ff.

Meaning of 'interests of members'

The conduct must be unfairly prejudicial to the 'interests' of all or some part of the members. Whether the affected interests must be those of members, in their capacity as members, is considered later. But certainly the term 'interests' is wider than 'rights', and the cases show that regard can be had to 'legitimate expectations'[48] (particularly in a small company) that the member will be employed by the company, or have a say in its management, or receive some return in the form of dividends.

But the judge 'does not sit under a palm tree':[49] although the court may have regard to 'wider' equitable considerations beyond the parties' strict constitutional and statutory rights, it cannot simply add still further rights and obligations arising from its own concept of fairness (*Re JE Cade & Son Ltd* [1992] BCLC 213 at 227; *O'Neill v Phillips***[13.30]**).

It follows that the more clearly and fully the parties have spelt out their arrangements, the less scope there will be for the court to find that there were other, unrecorded, 'legitimate expectations'. And if the company is a public company (more particularly if it has made a public issue of its shares) the court is most unlikely to take notice of any alleged arrangement that is not recorded in the company's published documents, for to do so would fly in the face of the principle that all material information must be disclosed to potential investors. Thus, in *Re Blue Arrow plc* [1987] BCLC 585 the court refused to grant any relief to a petitioner who alleged an agreement that she should remain in office as chairman; and in *Re Tottenham Hotspur plc* [1994] 1 BCLC 655 it declined to give effect to an alleged understanding that Terry Venables, the club's team manager, would continue to have a say in the company's management even after he had ceased to be a 50% shareholder.

Members in their capacity as members

A petitioner must show unfair prejudice in his or her character as a member and not, for example, as a director or creditor. *Re JE Cade & Son Ltd* [1992] BCLC 213 provides an illustration: the petitioner was a shareholder in a family farming company and was also the owner of land which the company held on an agricultural tenancy. The court found that his real object in bringing s 459 proceedings was not to obtain any relief in his capacity as a member but to obtain possession of the land, as landlord, and dismissed his claim.

But the rule is now applied more flexibly, following a lead given by the House of Lords in *Ebrahimi v Westbourne Galleries Ltd* **[16.13]**. In *Ebrahimi* the petitioner had been removed from office as a salaried director and so deprived of both his employment and any say in the management of the company, contrary to the basic assumptions on which this two-man company had been set up. In what is now the leading decision on the winding up of small companies, the House of Lords held that it was proper to have regard to 'wider' equitable considerations and not just the parties' strict legal rights in circumstances such as these, and granted him a winding-up order. But he failed on an alternative claim under CA 1948 s 210 (the forerunner of the present s 994) because, as that section was then construed, it **(p. 692)** was necessary for him to show that he had suffered oppression *as a member* rather than as a director or salaried employee. Soon after, s 210 was replaced and it was made clear that there would be a new departure: the same 'wider' equitable considerations would be applied in interpreting s 459 as the House of Lords had considered appropriate in the winding-up context in*Ebrahimi*.

For example, in *Re a Company* [1986] BCLC 376, Hoffmann J said (at 379):

> In the case of a small private company in which two or three members have invested their capital by subscribing for shares on the footing that dividends are unlikely but that each will earn his living by working for the company as a director … [the] member's interests as a member who has ventured his capital in the company's business may include a legitimate expectation that he will continue to be employed as a director and his dismissal from that office and exclusion from the management of the company may therefore be unfairly prejudicial to his interests as a member.

This reasoning resulted in the court issuing a buy-out order in *Re Eurofinance Group Ltd* [2001] BCC 551. And in *Re Phoenix Contracts (Leicester) Ltd* [2010] EWHC 2375 (Ch), Mr Shepherd was held to be entitled to be a working director, not merely a non-executive director, and so, accordingly, it was 'wholly artificial to draw a distinction between Mr Shepherd's role as an employee on the one hand and as a director and shareholder on the other' [115].

Use of CA 2006 s 994 to protect non-member interests

Using the unfair prejudice remedy to protect creditor interests.

[13.26] Gamlestaden Fastigheter AB v Baltic Partners Ltd [2007] UKPC 26 (Privy Council)

Gamlestaden was both a member and a creditor of Baltic. It sued under the Jersey equivalent of CA 2006 s 994, alleging unfair prejudice occasioned by the mismanagement of Baltic by its directors. It sought, by way of remedy, an order of the court that the directors pay damages to Baltic for their mismanagement. If successful, this claim would: (i) avoid possible limitation problems that existed in Baltic suing its own directors for their breach of duty; and (ii) put Baltic in funds which might be used to repay its creditors, including Gamlestaden, although not in sufficient funds to allow for any distribution to Baltic's members. The issue for the Board was whether the unfair prejudice provisions could deliver these ends.

> The decision of the Board was delivered by LORD SCOTT OF FOSCOTE:… Baltic is insolvent and the main issue for decision is whether it is open to a member of a company to make an unfair prejudice application for relief in circumstances where, as here, the company in question is insolvent, will remain insolvent whatever order is made on the application and where the relief sought will confer no financial benefit on the applicant *qua* member. The main relief now sought by Gamlestaden on its Article 141 application [the Jersey equivalent of CA 2006 s 994] is an order under Article 143(1) ordering the directors to pay damages to Baltic for breaches of the duty they owed to Baltic as directors. But it is accepted that the damages, assuming the claim succeeds, will not restore Baltic to solvency. It will, however, if it does succeed, produce a considerable sum which will be available to Baltic's creditors. Gamlestaden, either itself or as representing its parent company Gamlestaden AB, is a substantial creditor. The indebtedness in question was a major part of Gamlestaden's investment in Baltic's business ventures. So, it is said, Gamlestaden has a legitimate interest, in the particular circumstances of this case, justifying the making of the Article 141 application.
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> The directors, however, applied to have the application struck out on the ground that it was bound in law to fail. They contended before the Bailiff of the Royal Court and before the Court of Appeal, **(p. 693)** and have repeated the contention before the Board, that the alleged improprieties in the management of Baltic of which Gamlestaden complain cannot be shown to have caused Gamlestaden any financial loss in its capacity as shareholder. Its loss, if any, is suffered as a creditor. An application under Article 141 (or under section 459 of the 1985 Act) is, it is argued, a shareholder's remedy, not a creditor's remedy. Once it becomes clear that the only benefit to be derived from the relief sought in an unfair prejudice application would be a benefit to the company's creditors, and that no benefit would be obtained by the company's shareholders, it becomes clear that the application is an abuse of process, cannot succeed and should be struck out. The learned Bailiff agreed and struck out the application. The Court of Appeal dismissed

Gamlestaden's appeal. The point is now before the Board for a final decision. It must be emphasised that, since this appeal arises out of a strike out of the Article 141 application, the facts pleaded in support of the application must be taken as true (save for any that can be shown by incontrovertible evidence to be untrue). The Bailiff and the Court of Appeal approached the case on that footing and so must their Lordships.

The point at issue (identified in para. 3 above) depends, first, upon the scope of the power of the court under Articles 141 and 143, properly construed, in dealing with the unfair prejudice application and, secondly, upon the particular circumstances that are relied on for bringing this application within that scope. …

[Having decided that Gamlestaden was a member, and was therefore entitled to request relief under Art 43, Lord Scott continued:] The first question to be addressed, therefore, is whether an order for payment of damages to the company whose affairs have allegedly been conducted in an unfairly prejudicial manner can be sought and made in an unfair prejudice application. …

There is nothing in the wide language of Article 143(1) to suggest a limitation that would exclude the seeking or making of such an order: the court 'may make such order as it thinks fit for giving relief in respect of the matters complained of.'…

That leaves the important issue regarding Baltic's insolvency. Here, too, it is appropriate to start by noting the breadth of the Article 143(1) discretion conferred on the court. The court 'may make such order as it thinks fit for giving relief in respect of the matters complained of …'…

Bar the relatively trivial sum that Gamlestaden must have paid in subscribing for its 1100 shares in Baltic, Gamlestaden's investment took the form of the provision of loans to Baltic to enable Baltic to fund SPK. Baltic was the corporate vehicle through which the joint venture enterprise of Gamlestaden and Mr Karlsten of investment in German commercial property was to be pursued. If mismanagement by the directors of that corporate vehicle has led to loss it seems to their Lordships somewhat artificial to insist that the qualifying loss, for Article 141 (or section 459) purposes, must be loss which has reduced the value of the investor's equity capital and that it is not sufficient to show that it has reduced the recoverability of the investor's loan capital. …

[Counsel's] submission comes to this, that it is a fatal and insurmountable bar in any and every application for Article 141 (or section 459) relief if the relief sought cannot be shown to be of some benefit to the applicant shareholder in his capacity as shareholder.

Mr Moss [counsel] supported his submission by reference, in particular, to the well established rule that a shareholder cannot petition for a winding-up order to be made in respect of a company that is insolvent. The reason is that the petitioning shareholder cannot obtain any benefit from the winding-up. The company's assets will be realised; dividends may be paid to creditors but nothing, if the company is insolvent, will go to the members. The rule that Mr Moss prays in aid is a long established one and one on which their Lordships cast no doubt. But there is a significant difference between a creditor's winding-up petition and an Article 141 (or section 459) application. The former is seeking an order to put the company into an insolvent liquidation that will affect the interests of all creditors as well as of all members. It will involve the administration of the liquidation either by the Viscount (or, in England, the Official Receiver) and his officials or by a professional liquidator who, in carrying out his duties, will be an officer of the court. The liquidation, although from a financial point of view carried out for the benefit of creditors, is a public act or process in which the public has an interest. It seems to their Lordships quite right that a member **(p. 694)** with no financial interest in the process or its outcome should be denied *locus standi* to initiate the process.

Where relief is sought via an unfair prejudice application, on the other hand, the position is quite different. There is no public involvement or interest in the proceedings, other than the natural interest that may attend any proceedings heard in open court. The purpose of Article 141, or of section 459, or of their counterpart in Hong Kong, is to provide a means of relief to persons unfairly prejudiced by the management of the company in which they hold shares. If the company is a joint venture company and the joint venturers have arranged that one, or more, or all of them, shall provide working capital to the company by means of loans,