The rule also means that there can be no registration of a trust as such. An entry on the register such as 'The ABC Family Trust' would be an infringement of s 126. The correct entry and the share certificate should show merely the names of the individual trustees without any reference to the fact that they are trustees or the nature of the trusts. If a note of the existence of the trust is required for administrative purposes this can be recorded outside the register possibly with a coded cross-reference.

If a trustee of shares is entered on the register, he is personally liable for the calls made by the company, though he can claim an indemnity to the extent of the trust property and, if this is not sufficient, from the beneficiaries personally. A company cannot put a beneficiary on the list of contributories in a winding-up, though it can enforce the trustee's right of indemnity against the beneficiaries by the doctrine of *subrogation* (*per* James LJ in ***Re European Society Arbitration Acts*** (1878) 8 Ch D 679).

A company claiming a *lien* on its shares will be affected by a notice of any charge which arose prior to the debt in respect of which the company's lien is being exercised. As we have seen, this is not regarded as a notice of trust, but is more by way of a notice of lien as between one trader and another (see ***Bradford Banking Co*** v ***Briggs***, 1886).

Termination of membership

Termination of membership is complete when the name of a former member is removed from the register. This may occur by:

(a) transfer of the shares to a purchaser or by way of gift (subject to liability to be put on the list of members for one year if the company goes into liquidation) (see further Chapter 27);
See p. 593
(b) forfeiture, surrender, or a sale by the company under its lien;
(c) redemption or purchase of shares by the company;
(d) the registration of a trustee in bankruptcy, or by his disclaimer of the shares;
(e) death of the member;
(f) rescission of the contract to take the shares arising out of fraud or misrepresentation in the prospectus, or by reason of irregular allotment;
(g) dissolution of the company by winding-up or amalgamation or reconstruction under Insolvency Act 1986, s 110 (see Chapter 24);
See p. 530
(h) compulsory acquisition (see further Chapter 24);
(i) under the provisions of the company's constitution, e.g. expulsion under the articles for competing with the company (see ***Sidebottom*** v ***Kershaw Leese***, 1920).

Director and substantial shareholdings

As we have seen, the register of members merely gives the identity of the person in whose name the shares are registered. No indication is given of any interests in the shares which persons other than the registered holder might have. Furthermore, no notice of trust is to be entered on the register of members of a company registered in England. Where share warrants are in issue the position is, of course, worse since the names of the holders at any point of time are unknown, there being no form of registration.

This situation is capable of abuse. For example, it enables directors to traffic in the securities of their companies without this being known, or someone secretly to acquire control of a sizeable holding on which to base a bid for control.

The Companies Act deals with the above problems as follows.

The purchase and sale of the company's securities by the directors

Section 96A(2)(f) of the Financial Services and Markets Act 2000, states that anyone who discharges managerial responsibilities must disclose transactions conducted on their own account in shares of the company or derivatives or any other financial instrument relating to those shares.

Section 96B(1) goes on to clarify that the term 'discharging managerial responsibilities' means a director, a senior executive who has regular access to inside information relating directly or indirectly to the company, and to a senior executive who has power to make managerial decisions affecting the future development and business prospects of the company. This wording extends the scope of the regime beyond that outlined by the Companies Act 1985, but it would appear that the term 'shadow director' has been omitted under the reforms (see s 324(6), CA 1985).

Nevertheless, s 96B(2) goes on to state that the obligation extends to persons connected with anyone who discharges managerial responsibilities within the company. This covers those previously envisaged as falling within the remit of 'connected person' outlined in s 346 of the Companies Act 1985, as well as to a relative who has on the relevant date shared the same household as that person for at least 12 months, and a body corporate in which a person 'discharging managerial responsibilities' is a director or senior executive.

The Disclosure and Transparency Rules (DTR) require information about the transactions to be disclosed to the company, including under DTR 3.1.3, the price and volume of the transaction, within 4 business days of the transaction taking place (DTR 3.1.2). This information must then be passed on by the company to both the market as well as to the Financial Services Authority (FSA) within one business day (DTR 3.1.2 and 3.1.4).

Unlike under s 325 of the Companies Act 1985, the company is no longer required to maintain a register of directors' interests and dealings, or to report the position on directors' interests at the end of the financial year in the directors' report (Sch 7, CA 1985). However, the company is required to file an annual statement with the FSA making reference to all the information made public over the previous 12 months.

Substantial share interests

The current European Community principles regarding the disclosure of interests in share holdings is contained in Directive 2004/109/EC, known as the Transparency Directive (TD). This has seen the removal of the automatic disclosure requirements under the Companies Act and the transfer of a substantial part of these disclosure requirements to the Financial Services and Markets Act 2000 (FSMA). Indeed, the Companies Act 2006 has amended the FSMA to permit the area to be regulated by the FSA. In this respect, s 1266 of the CA 2006 inserts ss 89A–89G in to the FSMA 2000. In addition, the FSA has introduced the DTR to deal with this area.

This regime applies to companies which trade on a regulated market (Art 9(1) TD) as opposed to all public companies as *per* s 198 of the CA 1985. The domestic regime which has implemented the Directive applies to all companies with securities traded on a prescribed market, including any market operated by a Recognised Investment Exchange.

The disclosure requirements deal with the percentage of voting rights held in a company as opposed to the actual holdings of shares. Consequently, according to DTR 5, holdings of non-voting shares do not have to be disclosed under this regime, nor do shares which are only entitled to vote in certain circumstances (i.e. variation of class rights). However, it should be noted that those exercising managerial responsibilities within the company are required to disclose holdings in non-voting shares as this could give rise to insider dealing.

The notifiable percentage is 3 per cent of the total voting rights in the company and every 1 per cent thereafter. Once these thresholds have been crossed, the individual is required to disclose the interest to the company within two days (DTR 5.8.3).

Notification must be made, therefore, whenever a known change brings about a known increase or decrease above or below 3 per cent or a known increase or decrease to the next percentage point occurs in an interest exceeding 3 per cent. Thus, if a person has an interest in, say, 10.5 per cent of relevant capital, there is no requirement to notify a change in the interest unless and until it falls below 10 per cent or increases to 11 per cent.

The company must be notified within two days of the change and the company must record the details in a register of interests in shares. The register must be available for inspection without charge by any member or by any other person.

A person who fails to notify as required or gives false or misleading information is liable to a fine or imprisonment or both.

Power of public company to investigate interests

Section 1295 of the Companies Act 2006 repealed s 212 of the CA 1985, which had enabled a public company to previously make enquiries of *any person* (not merely a member) whom it knew or had reasonable cause to believe to be *interested* in any of its voting shares either at the present time or at any time during the preceding three years. This repeal impacts on any s 212 notice issued after 20 January 2007.

The annual return

Under s 854 of the Companies Act 2006, a company must file an annual return with the Registrar. It must be made up to a date 12 months after the previous return or in the case of the first return 12 months after incorporation (s 854(2)).

The return must be delivered to the Registrar within 28 days of the make-up date (s 854(3)(b)) and must contain the information required by or under the provisions of Part 24 of the 2006 Act.

Contents of annual return

Section 855 of the Companies Act 2006 states that every annual return must state the date to which it is made up and contain the following information:

(a) the address of the company's registered office;
(b) the type of company it is and its principal business activities;
(c) the prescribed particulars of (i) the directors of the company, and (ii) in the case of a private company with a secretary or a public company, the secretary or joint secretaries;

(d) if the register of members is not kept available for inspection at the company's registered office, the address of the place where it is kept available for inspection;
(e) if any register of debenture holders is not kept available for inspection at the company's registered office, the address of the place where it is kept available for inspection.

Furthermore, s 856(1) goes on to provide that the annual return of a company having share capital must also contain a statement of capital and the particulars required by s 856(3) to 856(6) about the members of the company. In this regard, s 856(2) states that the statement of capital must state with respect to the company's share capital at the date to which the return is made up:

(a) the total number of shares of the company;
(b) the aggregate nominal value of those shares;
(c) for each class of shares: (i) prescribed particulars of the rights attached to the shares; (ii) the total number of shares of that class; and (iii) the aggregate nominal value of shares of that class, and;
(d) the amount paid up and the amount (if any) unpaid on each share.

Section 856(3) goes on to state that the return must contain the prescribed particulars of every person who: (a) is a member of the company on the date to which the return is made up, or (b) has ceased to be a member of the company since the date to which the last return was made up (or, in the case of the first return, since the incorporation of the company).

The subsection also sets down that the return must conform to such requirements as may be prescribed for the purpose of enabling the entries relating to any given person to be easily found.

In addition, s 856(4) requires that the return must also state: (a) the number of shares of each class held by each member of the company at the date to which the return is made up; (b) the number of shares of each class transferred: (i) since the date to which the last return was made up; or (ii) in the case of the first return, since the incorporation of the company, by each member or person who has ceased to be a member; and (c) the dates of registration of the transfers.

Finally, s 856 (6) sets out that where the company has converted any of its shares into stock, the return must give the corresponding information in relation to that stock, stating the amount of stock instead of the number or nominal value of shares.

Sanctions if return not made

Section 858(1) provides that if a company fails to deliver an annual return before the end of the period of 28 days after a return date, an offence is committed by the company and, subject to s 858(4), every director of the company, and in the case of a private company with a secretary or a public company, every secretary of the company, and every other officer of the company who is in default.

Section 858(2) goes on to state that a person guilty of such an offence is liable to a fine and, for continued contravention, a daily default fine. The contravention continues until such time as an annual return made up to that return date is delivered by the company to the registrar (s 858(3)).

Power to make further provision by regulations

Section 857(1) states that the Secretary of State may by regulations make further provision as to the information to be given in a company's annual return. The section goes on to note that the regulations may amend or repeal the provisions of ss 855 and 856, and provide for exceptions from the requirements of those sections as they have effect from time to time (s 857(2)).

Essay questions

1 Describe an Annual Return and state the particulars which must be given in the Annual Return of a company which has a share capital. (*The Institute of Company Accountants*)

2 Every public company is required to maintain a register of 'substantial holdings and interests' in shares which it has issued.

(a) What duties are imposed upon persons to notify such holdings and interests?

(b) What is the purpose of the requirement?

(*The Institute of Chartered Accountants in England and Wales*)

3 Privatus Ltd was a private company which owed the sum of £4,000 to Alex for goods which he had sold to it. As the company was short of cash, its directors allotted to Alex 6,000 £1 shares in the company credited as fully paid. The share certificate issued to Alex stated that the shares were fully paid.

Alex contracted to sell these shares to Bertram and duly handed him the share certificate and a signed stock transfer form. When Bertram sent these documents to the company in order to have the transfer registered, the directors became concerned that problems might arise over the original issue to Alex. They discussed the matter over a four-month period and then wrote to Bertram informing him that in accordance with Art 24 of the company's articles of association they refused to register his transfer. Article 24 reads, 'The directors may refuse to register the transfer of a share which is not fully paid to a person of whom they do not approve.' Bertram has now begun a court action to secure his registration as a member.

Advise the company of its position with regard to the issue of the shares to Alex and the action brought by Bertram. (*The Association of Chartered Certified Accountants*)

4 The Companies Act 2006 places upon public companies certain controls over the type and value of the consideration which such companies may receive for an issue of their shares. You are required to select any three of these controls and explain in each instance how the control restricts the company and why, in your view, the provision was enacted.

(*The Chartered Institute of Management Accountants*)

5 The following is a summarised balance sheet of C Ltd:

	£	£
Authorised Capital		
100,000 Ordinary Shares of £1 each	100,000	
10,000 – 10 per cent Redeemable Preference Shares of £1 each	10,000	110,000
Total Assets (including Cash at Bank of £50,000)		400,000
Liabilities		200,000
Net Assets		200,000
Represented by:		
Issued Capital		
100,000 Ordinary Shares of £1 each		100,000
10,000 – 10 per cent Redeemable Preference Shares		10,000
		110,000
Capital Reserve (Share Premium a/c)	10,000	
Revenue Reserves	80,000	90,000
		£200,000

The directors seek your advice as to how they may redeem the preference shares and whether they may issue 20,000 bonus Ordinary Shares of £1 each. Advise them on these matters and redraft the balance sheet as it would appear after implementing your advice.

(*Kingston University*)

6 (a) 'A company cannot issue shares at a discount.'

Discuss.

(b) False Ltd and Gorgon Ltd both have an issued share capital of £500,000 and a share premium account of £50,000. The directors of False Ltd have recently decided that it is over-capitalised and wish to return £55,000 to the shareholders. Gorgon Ltd has recently made a loss of £55,000 and its directors wish to reduce the company's capital accordingly.

Advise the directors of both companies.

(*The Institute of Chartered Secretaries and Administrators*)

Test your knowledge

Four alternative answers are given. Select ONE only. Circle the answer which you consider to be correct. Check your answers by referring back to the information given in the chapter and against the answers at the back of the book.

1 A person who acquires an interest in the shares of a public company must notify the company of that interest when it equals or exceeds:

A 20 per cent of the voting shares.
B 10 per cent of the voting shares.
C 5 per cent of the voting shares.
D 3 per cent of the voting shares.

2 Tees plc has an issued share capital of £100,000 and recently issued another 100,000 £1 ordinary shares. Fred, his wife, his son (aged 18) and a private company in which Fred is the majority shareholder each acquired 10,000 shares. What is the interest which Fred must notify to the company under the Companies Act 2006?

A 40,000 shares **B** 30,000 shares **C** 20,000 shares **D** 10,000 shares

3 The Companies Act 2006 requires that when equity shares are allotted for cash they must be offered first to existing shareholders in proportion to their holding in the company. Such an issue of shares is known as:

A A rights issue.
B A preference issue.
C An issue of bonus shares.
D An issue of founders' shares.

4 How is a share warrant validly transferred?

A By any writing.
B By writing and delivery.
C By delivery.
D By instrument of transfer.

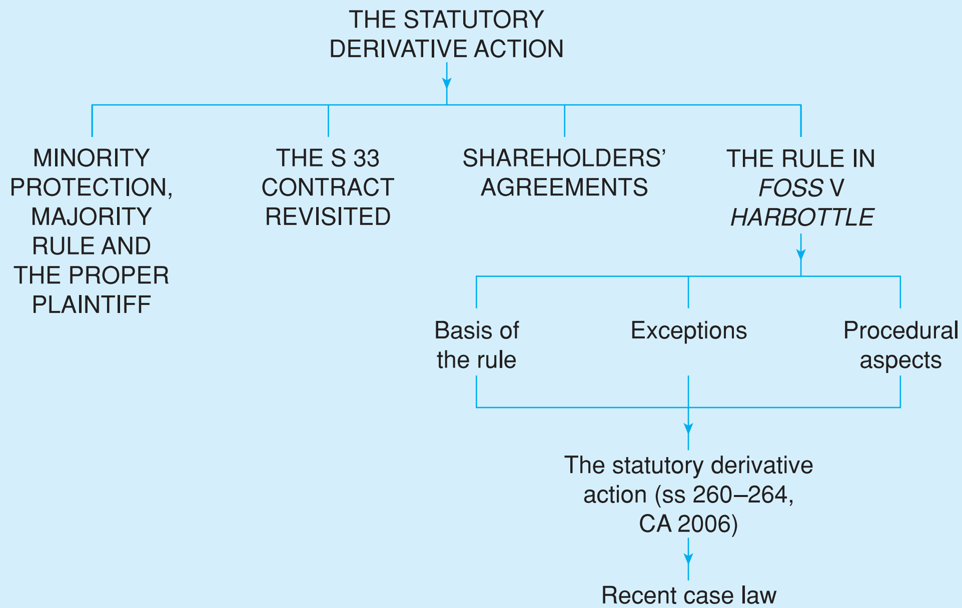
5 The articles of private companies often provide that members wishing to sell their shares must offer them first to existing members. What is such a clause called?

A An expropriation clause.
B A compulsory purchase clause.
C A pre-emption clause.
D A statutory pre-emption clause.

The answers to test your knowledge questions appear on p. 616.

Visit **www.mylawchamber.co.uk/keenancompany** to access study support resources including practice exam questions with guidance, weblinks, legal newsfeed, answers to questions in this chapter, legal updates and further reading.

15 The statutory derivative action



The following two chapters are concerned with the various remedies available to minority shareholders. It should be noted from the outset that many of these remedies are concerned with the actions or conduct of the company's officers (e.g. directors), which infringe the rights or affect the interests of shareholders. Equally, it should be noted that not all of these remedies provide a personal remedy to the shareholder in question. Rather, actions under the exceptions to the rule in ***Foss* v *Harbottle*** (now in statutory form), are referred to as being 'derivative actions'. In other words, the minority shareholder undertakes such an action on behalf of, and for the ultimate benefit of, the company and not himself/herself.

Chapter 15 will revisit briefly the s 33 statutory contract, the wording of which suggests that the parties (i.e. shareholders) to it are in a position to enforce the provisions of the company's constitution. Therefore, in terms of shareholder remedies, if a member has a right that is contained in the articles and is a party to the statutory contract, that member may enforce their right. Equally, if a member has a right contained in the articles that is being thwarted, that individual may sue for breach of contract, (see ***Browne* v *La Trinidad***). Consequently, it is recommended that this heading should be the first option that is considered when addressing issues of shareholder remedies as it is potentially:

1 a straightforward enforcement of a contractual right/obligation;
2 far less expensive and time consuming for the minority shareholder.

Chapter 15 will then go on to examine the rule in ***Foss* v *Harbottle*** and the minority shareholders' actions which are permitted by the exceptions to it, as set out in the case of ***Edwards* v *Halliwell*** and how this rule has, under the Companies Act 2006, been moved into statutory form. The case of ***Foss* v *Harbottle*** represents the general principle of company law that minority shareholders cannot sue for wrongs done to the company or complain of irregularities in the conduct of its internal affairs. This rule rests on two related propositions:

1 the right of the majority to bar a minority action whenever they might lawfully ratify the alleged misconduct (the principle of majority rule); and
2 the normally exclusive right of the company to sue upon a corporate cause of action (the principle of the proper plaintiff).

Chapter 16 will continue the discussion of 'minority protection' with an examination of two interrelated statutory remedies. First of all, s 994 of the Companies Act 2006, which permits a member (shareholder) of a company to petition on the ground of unfair prejudice as well as s 122(1)(g) of the Insolvency Act 1986, which provides a 'just and equitable' ground for a member to petition to have the company wound up.

These statutory remedies (particularly s 994) evolved in response to the undue technicality and doctrinal obscurity of the rule in ***Foss* v *Harbottle***, aiming to provide a broader and more liberal judicial discretion to the area of shareholder remedies (see the case of ***O'Neill* v *Phillips***). However, despite this rather positive development in the law, it should be noted that their beneficial effect is largely restricted to small and/or medium-sized private companies. Quite simply, these two remedies are not an appropriate method of dealing with issues such as corporate abuse in public listed companies (see the case of ***Re Blue Arrow plc*** in Chapter 16).

See p. 321

The s 33 contract revisited

Unlike s 14 of the Companies Act 1985, s 33 refers to '*a company's constitution*', rather than its '*memorandum and articles*'. This reflects the new division of formation and constitutional information between the memorandum, articles and other constitutional documents noted above.

However, as outlined in earlier chapters, this option is not without its problems. As such, you should try to address the following issues. First of all, is the individual in question a party to the statutory contract (***Hickman* v *Kent or Romney Marsh Sheepbreeders Association***)? Secondly, does the right in question fall within the scope of enforceable rights under s 33? (In other words, is it an insider or outsider right (see ***Quin & Axtens* v *Salmon***, 1909; ***Eley* v *Positive Life Association***, 1876; ***Beattie* v *E & F Beattie Ltd***, 1938)?)

In many instances, there may not be a straightforward answer to these questions. Nevertheless, you should always consider this process at the beginning of any minority protection question. Do not automatically dismiss the possibility of enforcement under the statutory contract.

Shareholders' agreements

As noted in previous chapters, many small private companies have converted from partnerships where a partnership contractual agreement has governed the business affairs. Such an agreement has a vital role to play in terms of s 17 of the Companies Act 2006, which now states that a company's constitution consists of the articles of association and any resolutions and agreements to which Chapter 3 of the 2006 Act applies. In addition, it plays an invaluable role in terms of evidencing the expectations of a company's members at the time the agreement was drawn up as it will normally contain provisions on how decisions are to be made on matters such as directors' pay, dividends and the employment of key staff. The agreement is designed so that shareholders with big holdings cannot in all cases impose their will through majority voting power, and is of particular importance where shareholder voting can result in damaging deadlock. One of the most important aspects of the agreement will be the provisions for share valuation on the sale of shares, on leaving the company by retirement or by death (see Chapter 3 above).

The rule in *Foss* v *Harbottle*

Although many functions are delegated to the directorate, the eventual power and control in a company rests with those shareholders who can command a majority of the voting power. Thus, a person or group of persons controlling three-quarters of the votes would have complete control of the company, and a little more than half the votes would give considerable influence allowing, for example, control over appointments to the board.

The principle of majority rule is well established and is emphasised in the matter of litigation by the rule in ***Foss* v *Harbottle***, 1843 (see below). Generally it does little harm since most companies are managed fairly, even if at times there is not due concern for the rights of

minorities which might lead to oppression. The problem is at its greatest in private companies because the shares of such companies are not listed on the Stock Exchange, the protection of the Stock Exchange rules is not available, and there is rarely any press comment on their activities.

The rule in ***Foss*** v ***Harbottle***, 1843 states that in order to redress a wrong done to a company or to the property of the company, or to enforce rights of the company, the proper claimant is the company itself, and the court will not ordinarily entertain an action brought on behalf of the company by a shareholder.

Foss **v** ***Harbottle*** (1843) 2 Hare 461

The claimants, Foss and Turton, were shareholders in a company called 'The Victoria Park Company' which was formed to buy land for use as a pleasure park. The defendants were the other directors and shareholders of the company. The claimants alleged that the defendants had defrauded the company in various ways, and in particular that certain of the defendants had sold land belonging to them to the company at an exorbitant price. The claimants now asked the court to order that the defendants make good the losses to the company.

Held – by Vice-Chancellor Wigram – since the company's board of directors was still in existence, and since it was still possible to call a general meeting of the company, there was nothing to prevent the company from obtaining redress in its corporate character, and the action by the claimants could not be sustained.

Basis of the rule

Four major principles seem to be at the basis of the rule as the decided cases show:

1 **The right of the majority to rule.** The court has said in some of the cases that an action by a single shareholder cannot be entertained because the feeling of the majority of the members has not been tested, and they may be prepared, if asked, to waive their right to sue. Thus the company can only sue (a) if the directors pass a resolution to that effect where the power is delegated to them; or (b) if the company expresses its desire to sue by an ordinary resolution in general meeting, whether the power is delegated to the directors or not, since the power of the members to bring the company into court as a claimant is concurrent with that of the directors, and if the members wish to bring the company into court and the directors do not, the wish of the members by ordinary resolution will prevail.

2 **The company is a legal person.** The court has also said from time to time that since a company is a *persona at law*, the action is vested in it, and cannot be brought by a single member.

3 **The prevention of a multiplicity of actions.** This situation could occur if each individual member was allowed to commence an action in respect of a wrong done to the company. See James LJ in ***Gray*** v ***Lewis*** (1873) 8 Ch App 1035 at p 1051 – a judgment which is particularly supportive of the multiplicity problem.

4 **The court's order may be made ineffective.** It should be noted that the court order could be overruled by an ordinary resolution of members in a subsequent general meeting, provided that the general meeting is not controlled by the wrongdoers (see below). As Mellish LJ said in ***MacDougall*** v ***Gardiner*** (1875) 1 Ch D 13 at p 25,

> [. . .] if the thing complained of is a thing which in substance the majority of the company are entitled to do [. . .] there can be no use in having a litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes.

It will be seen, therefore, that the rule in ***Foss*** is in no sense helpful to the minority. This rule means that, for good or bad, the decision-making power within a company lies with those in control of more than half of the votes in general meetings or boards of directors. In fact, if there were no exceptions to the rule, the minority could never bring a claim at all. It is to the exceptions that we must now turn. Consequently, at common law, if the minority shareholder disagrees with the majority, he has little room to complain. In many instances, the unhappy shareholder in a public limited company is encouraged to use his 'power of exit' – in other words to sell his shares on the Stock Market.

However, consider the position of a minority shareholder within a private limited company: Where is the available market? Is the shareholder able to sell his shares to individuals external to the company? (Consider pre-emption clauses.) How will the shares be valued? The main exception to this restriction on the ability of the minority shareholder to object to the actions of the majority arises in instances where there is a 'fraud on the minority'. However, even in these circumstances success is not guaranteed.

The obscure nature of the rule in ***Foss* v *Harbottle*** has meant that in the past individuals have been refused a remedy, despite the merits of the case.

However, since October 2007, minority shareholders have been allowed a new statutory derivative action. The two rules in ***Foss* v *Harbottle*** will continue to apply, although the absence of one or the other will no longer be a bar to commence proceedings. Before exploring the new statutory derivative action, it is necessary to provide some context for the rule (and the exceptions to the rule contained in ***Edwards* v *Halliwell***) in ***Foss* v *Harbottle***.

Acts infringing the personal rights of shareholders

See p. 101

These actions are not so much genuine exceptions to the rule in ***Foss***, they are more in the nature of situations which are outside it. Thus, in ***Pender* v *Lushingon***, 1877 (see Chapter 4) the court dealt with the attempted removal of the claimant's right to vote without suggesting that the rule in ***Foss*** in any way prevented the action from being brought.

Exceptions to the rule – generally

Although the courts have not developed an entirely clear pattern of exceptions, those set out below appear to be the main areas in which the court will allow claims to be brought by shareholders as an exception to the rule in ***Foss*** (which has now been replaced by the new provisions of the CA 2006).

1 **Acts which are *ultra vires* or illegal.** No simple majority of members can confirm or ratify an illegal act. Section 39 of the Companies Act 2006 gives an individual member a *statutory* right to ask the court for an injunction to restrain the directors from entering into *ultra vires* transactions but *not* if the members of the company have ratified a particular transaction by special resolution. So far as illegality is concerned, the minority could bring an action to force the directors to comply with the law restricting, for example, loans, quasi-loans and credit given by the company to directors and their connected persons.

2 **Where the act complained of can only be confirmed by a special or extraordinary resolution.** *Foss* is based on the principle that the majority, i.e. those who can obtain an ordinary resolution, should decide whether or not a complaint relating to the company should be brought before the court. Clearly, therefore, a simple majority of the members cannot be allowed to confirm a transaction requiring a greater majority.

***Edwards* v *Halliwell* [1950] 2 All ER 1064**

A trade union had rules, which were the equivalent of articles of association, under which any increase in members' contributions had to be agreed by a two-thirds majority in a ballot of members. A meeting decided by a simple majority to increase the subscriptions without holding a ballot. The claimants, as a minority of members, applied for a declaration from the court that the resolution was invalid.

Held – the rule in ***Foss*** did not prevent a minority of a company, or as here, an association of persons, from suing because the matter about which they were suing was one which could only be done or validly sanctioned by a greater than simple majority. This was broken down as follows:

(i) On the construction of the rules, the alteration in the rates of contribution was invalid;

(ii) The rule in ***Foss* v *Harbottle*** did not afford the trade union a defence because it protected only irregularities concerning matters which were *intra vires* the union and pertained to its internal management; a mere irregularity meant something not involving fraud, oppression or unfairness, but the action complained of here was strongly tinctured with oppression or unfairness;

(iii) The rule did not apply where a matter was in issue which could only be sanctioned by some special majority;

(iv) The case was not within the ambit of the rule, for the substance of the complaint was that the majority had invaded the individual rights of members.

3 **Where there is a fraud on the minority.** The rule in *Foss* would create grave injustice if the majority were allowed to commit wrongs against the company and benefit from those wrongs at the expense of the minority simply because no claim could be brought in respect of the wrong. Thus, there is a major and somewhat ill-defined exception referred to as 'fraud on the minority'. For example, in ***Estmanco (Kilner House) Ltd* v *Greater London Council*** [1982] 1 All ER 437, Megarry V-C noted that: 'It does not seem to have yet become very clear exactly what the word "fraud" means in this context; but I think it is plainly wider than fraud at common law . . .' Equally, in ***Burland* v *Earle*** [1902] AC 83, the court stated that a straightforward example of fraud is '. . . where a majority are endeavouring directly or indirectly to appropriate to themselves money, property or advantages which belong to the company'. However, in ***Pavlides* v *Jensen***, 1956 (see below), it was held that a loss caused to a company through the negligence of its directors who had derived no personal gain through the transaction did not constitute a fraud on the minority. Finally, in ***Daniels* v *Daniels*** [1978] Ch 406 (below) it was held that a derivative claim arose where a substantial profit was made upon the resale of company land sold to a director. Therefore, it should be noted that fraud in this context is not confined to literal or common law fraud and may include the misappropriation of corporate property; mala fide abuse of power (refer to directors' duties); discrimination against a section of the membership; as well as errors of judgment from which the directors have benefited. The following headings describe the main areas of fraud.

(a) **Where the company is defrauded.** Examples of this exception are to be found in the following cases which involved misappropriation of the company's property.

***Menier* v *Hooper's Telegraph Works Ltd* (1874) 9 Ch App 350**

Company A (European and South American Telegraph Co) was formed to lay a transatlantic cable to be made by Hooper's, the majority shareholder in company A, from Portugal to Brazil. Hooper's found that they could make a greater profit by selling the cable to another company B, but B did not have the government concession to lay the cable which company A had. After much intrigue with the Portuguese government trustee of the concession, he agreed to transfer the concession to company B, and company B then bought the cable from Hooper's. To prevent company A from suing for loss of the concession Hooper obtained the passing of a resolution to wind up company A voluntarily and arranged that a liquidator should be appointed whom Hooper could trust not to pursue the claim of company A in respect of the loss of its contract. Menier, a minority shareholder of company A, asked the court to compel Hooper to account to company A for the profits made on the sale of the cable to B.

Held – by the Court of Appeal in Chancery – where the majority shareholders of a company propose to gain a benefit for themselves at the expense of the minority, the court may interfere to protect the minority. In such a case one shareholder has a right to bring a derivative claim to seek relief and the claim is not barred by the rule in ***Foss* v *Harbottle***. This was a blatant case of fraud and oppression and Hooper's were trustees of the profit and had to account to company A for it.

Comment

It seems that in cases like ***Menier*** and ***Cook*** (below) it is the company which is defrauded. It might therefore be better to rename the jurisdiction as 'fraud upon the company'. The claim is, after all, brought on behalf of the company and is therefore derivative (see below), and the company takes the benefit of any damages recovered. The value of the shares may fall giving a loss to individual shareholders but since the Court of Appeal held in ***Prudential Assurance Co Ltd* v *Newman Industries*** [1982] 1 All ER 354 that this loss was not recoverable by individual shareholders, at least where it is caused by fraud or negligence, it seems that the claim is basically for defrauding the company.

***Cook* v *Deeks* [1916] 1 AC 554**

This action was brought in the High Court Division of the Supreme Court of Ontario by the claimant, suing on behalf of himself and other shareholders in the Toronto Construction Co Ltd, against the respondents, who were directors of the company. The claimant sought a declaration that the respondents were trustees of the company of the benefit of a contract made between the respondents and the Canadian Pacific Railway Co for construction work. It appeared that the respondents, while acting on behalf of the company in negotiating the contract, actually made it for themselves and not for the company, and by their votes as holders of three-quarters of the issued share capital, subsequently passed a resolution at a general meeting declaring that the company had no interest in the contract.

Held – by the Privy Council:

(a) that the contract belonged in equity to the company, and the directors could not validly use their voting powers to vest the contract in themselves, in fraud of the minority;
(b) in cases of breach of duty of this sort, the rule in ***Foss* v *Harbottle*** did not bar the claimant's claim.

Comment

See p. 334

In ***Industrial Development Consultants*** v ***Cooley***, 1972 (see Chapter 17) there was a not dissimilar misappropriation of a corporate opportunity. However, in the *Cooley* case there was no need to resort to a derivative claim because Mr Cooley had made the profit for himself. The whole board was not involved and was clearly anxious to bring the company into court in order to sue Mr Cooley for recovery of the profit.

(b) **Where the minority as individuals are defrauded**

(i) *Expulsion of minority*. This will amount to fraud unless it is done bona fide and for the benefit of the company.

Brown **v** ***British Abrasive Wheel Co*** [1919] 1 Ch 290

The company required further capital. The majority, who represented 98 per cent of the shareholders, were willing to provide this capital but only if they could buy up the 2 per cent minority. The minority would not agree to sell and so the majority shareholders proposed to alter the articles to provide for compulsory acquisition under which nine-tenths of the shareholders could buy out any other shareholders.

Held – by Astbury J – that the alteration of the articles would be restrained because the alteration was not for the benefit of the company. In addition, the rule in ***Foss*** v ***Harbottle*** did not bar the claimant's claim.

Comment

A contrast is provided by ***Dafen Tinplate Co Ltd*** v ***Llanelli Steel Co*** *(1907) Ltd*, 1920, and ***Sidebottom*** v ***Kershaw Leese & Co***, 1920 (see Chapter 5).

See p. 119

(ii) *Inequitable use of majority power*. An example of this jurisdiction is to be found in the following case.

Clemens **v** ***Clemens Bros*** [1976] 2 All ER 268

In this case the issued share capital of £2,000 in a small but prosperous family company was held between the claimant (45 per cent) and her aunt (55 per cent), the aunt being one of the five directors of the company. The directors proposed to increase the company's share capital to £3,650 by the creation of a further 1,650 voting ordinary shares. The four directors, other than the aunt, were to receive 200 shares each, and the balance of 850 shares was to be placed in trust for the company's long-service employees. The claimant objected to the proposed resolution to put this scheme into effect since the result would be to reduce her shareholding to under 25 per cent. At the extraordinary general meeting called to approve the scheme, the aunt voted in favour of the resolutions which were passed. The claimant sought a declaration against both the company and the aunt that the resolutions should be set aside on the ground that they were oppressive of the claimant. The defendant contended that if two shareholders honestly hold differing opinions, the view of the majority should prevail, and that shareholders in general meeting were entitled to consider their own interests and to vote in any way they honestly believed proper in the interest of the company. In giving judgment in favour of the claimant, Foster J made it clear that in the circumstances of this case Miss Clemens (the aunt) was not entitled to exercise her majority vote in whatever way she pleased. The judge found difficulty, however, in expressing this as a general principle

of law, in terms, for example, of expressions such as 'bona fide for the benefit of the company as a whole', 'fraud on a minority', and 'oppressive'. He came to the conclusion that it would be unwise to try to produce a principle because the circumstances of each case are infinitely varied. He did say, however, following a phrase of Lord Wilberforce in ***Westbourne Galleries*** (see Chapter 1), that the right of a shareholder to exercise voting rights in any way whatever is subject always to equitable considerations which may in particular circumstances make it unjust to exercise votes in a certain way. Dealing with the facts before him, Foster J then went on to say:

See p. 40

> I cannot escape the conclusion that the resolutions have been framed so as to put into the hands of Miss Clemens and her fellow directors complete control of the company and to deprive the [claimant] of her existing rights as a shareholder with more than 25 per cent of the votes, and greatly reduce her rights. They are specifically and carefully designed to ensure not only that the [claimant] can never get control of the company, but to deprive her of what has been called her negative control. [Here the judge is referring to her ability to block special and extraordinary resolutions.] Whether I say that these proposals are oppressive to the [claimant] or that no-one could honestly believe that they are for her benefit, matters not. A court of equity will in my judgment regard these considerations as sufficient to prevent the consequences arising from Miss Clemens using her legal right to vote in the way she has and it would be right for a court of equity to prevent such consequences taking effect.

Comment

(i) The case is quoted to show the very wide power which equity reserves to itself to control the activities of majority shareholders. On the particular facts of this case, of course, the pre-emption rights given to shareholders by s 89 should prevent the sort of prejudicial conduct towards a minority which was alleged in this case. The claimant could, of course, have prevented the other members from effecting the disapplication of pre-emption rights under s 95 because a special resolution is required for this (see further Chapter 19).

See p. 379

(ii) Although Foster J was not prepared to put the case into any existing category of ***Foss*** exceptions, fraud on the minority seems a possible one.

(iii) The allotment was presumably also invalid because it was an improper exercise of the directors' powers.

The exception of fraud on the minority depends *where the company is defrauded* on 'wrongdoer control', i.e. the individual shareholder must show that the wrongdoers control the company as where they control the board and general meetings and will not permit an action to be brought in the company's name. Furthermore, wrongdoer control is essential because cases of misappropriation of property and breach of duty can be ratified by a 51 per cent majority of the members which is not controlled by the wrongdoers. However, how does a shareholder demonstrate this? In other words, what is the process by which the shareholder establishes *locus standi* – the right to bring a derivative action on behalf of the company against these alleged wrongdoers in a particular case?

The wrongdoers will obviously be in the above position if they have voting control as they had, for example, in ***Menier*** and ***Cook***. However, in ***Prudential Assurance Co Ltd*** v ***Newman Industries Ltd*** [1980] 2 All ER 841 Vinelott J held that *de facto* control was enough, i.e. the company does what the wrongdoers want even though the wrongdoers do not have voting control. They are able to persuade the majority to follow them. The Court of Appeal did not accept this reasoning because it requires a trial to see if there is evidence of control, whereas voting control is obvious from shares held and voting rights. However, they gave no guidance as to what might be meant by control. This was followed by ***Smith*** v ***Croft (No 2)*** [1987] 3 All ER 909 in which it was noted that the court can investigate the conduct of the voting and count heads in order to assess the views of other shareholders, independent of the plaintiffs

and the wrongdoers, and in essence what they think should be done in the circumstances. In this scenario the organ capable of reviewing the matter will usually be the General Meeting. Following this, where the majority of independent shareholders would vote against legal proceedings, then no claim in the company's name should lie.

Smith* v *Croft (No 2) [1988] Ch 114

The articles of F Ltd provided that a director should be remunerated for his services at the rate of £150 per annum, the chairman receiving an additional £100 per annum, but the rate of remuneration could be increased by an ordinary resolution. The directors were also empowered to appoint one or more of their number to be holders of an executive office, and any director appointed to such office was to receive such additional remuneration by way of salary, lump sum, commission or participation in profits as the directors might determine. During the course of 1982 the appointed executive directors and companies with which they were associated acquired sufficient shares in F Ltd to give them overall voting control. The shares were bought by means of payments made to three of the associated companies in August 1982 of £33,000 each, part of which was then lent to the fourth to discharge a bank loan taken out for the purpose of obtaining cash to buy shares in F Ltd and the remainder was used for the purchase of shares by the three associated companies.

The plaintiffs, who held a minority of shares in F Ltd, brought an action against F Ltd, three executive directors and the chairman, a non-executive director, and four companies closely associated with one or other of the three executive directors, claiming that the directors had paid themselves excessive remuneration, that the payments in 1982 to the associated companies were contrary to section 42 of the Companies Act 1981 and that certain payments of expenses to directors were excessive. The plaintiffs between them held 11.86 per cent of the issued shares in F Ltd; the defendants between them held 62.54 per cent; of the remaining shares 2.54 per cent were held by a company which actively supported the plaintiffs, while 3.22 per cent were held by persons or companies which, it was common ground, were to be treated as supporting the defendants. W Ltd, a company not under the control of either the plaintiffs or the defendants, held 19.66 per cent of the shares in F Ltd and was opposed to the continuance of the plaintiffs' action.

The chairman and F Ltd sought a motion to strike out the plaintiffs' action under RSC, Ord 18, r 19 or under the inherent jurisdiction as vexatious, frivolous or an abuse of process.

Held – (1) that the defendants' application raised the issue whether the plaintiffs could proceed with their minority shareholders' action and, although that raised difficult questions of law, the defendants, by invoking the procedure under RSC, Ord 18, r 9 rather than the procedure for determining a preliminary issue of law under RSC, Ord 33, r 3, had not adopted such an inherently defective procedure that the court should not proceed to determine the issues raised; and that since the effect of the court deciding those issues against the plaintiffs would be determinative of the action, the court would entertain the application and consider whether prima facie the company was entitled to the relief claimed in the action and whether the action was within the exception to the rule in ***Foss* v *Harbottle***.

(2) That although excessive remuneration paid to directors might be an abuse of power, where the power to decide remuneration was vested in the board, it could not be *ultra vires* the company; and that in view of the uncontradicted evidence about the specialised field in which the company operated and the high levels of remuneration obtaining there it was more likely that the plaintiffs would fail than succeed on the issue of quantum; that likewise no prima facie case had been shown that the executive directors' expenses were excessive; and that, prima facie, the payments to associated companies were not ultra vires since payments at the request of an executive director to an outside entity were capable of being payments in respect of services rendered by the executive director, save that there was a prima facie case of irregularity regarding certain payments

not fully cured by subsequent adoption of the accounts at the annual general meetings at which those payments should have been disclosed; that since the admitted payments of £33,000 to associated companies had not been shown to be reasonably necessary for the purpose of providing for amounts likely to be incurred by way of directors' remuneration there was a prima facie case of infringement of s 42 of the Companies Act 1981.

(3) That although a minority shareholder had locus standi to bring an action on behalf of a company to recover property or money transferred or paid away in an *ultra vires* transaction, he did not have an indefeasible right to prosecute such an action on the company's behalf; that it was proper to have regard to the views of the independent shareholders, and their votes should be disregarded only if the court was satisfied that they would be cast in favour of the defendant directors in order to support them rather than for the benefit of the company, or if there was a substantial risk of that happening; that there was no evidence to suggest that the votes of W Ltd would be cast otherwise than for reasons genuinely thought to be for the company's advantage; and that, accordingly, since the majority of the independent shareholders' votes, including those of W Ltd, would be cast against allowing the action to proceed, the statement of claim should be struck out.

4 **Fraud and negligence.** It is still not entirely certain whether damage caused by *negligence* can be brought under the heading of 'fraud' for the purposes of the exception of 'fraud on the minority'. In ***Pavlides* v *Jensen***, 1956 (below) the court held that negligence, however gross, was not included. However, in ***Daniels* v *Daniels***, 1978 (below) Templeman J, in distinguishing ***Pavlides***, said that a minority shareholder who had no other remedy should be able to sue whenever directors use their powers intentionally or unintentionally, fraudulently or negligently, in a manner which benefits them at the expense of the company. Vinelott J accepted this view in the ***Newman*** case. The Court of Appeal in that case did not give any guidance but the general approach of the court was restrictive and suggests that negligence *which does not result in personal benefit* to the wrongdoers might still be ratifiable by a general meeting even with the votes of the wrongdoers and, therefore, not within the definition of fraud on the minority.

Pavlides* v *Jensen [1956] 2 All ER 518

The directors of the Tunnel Asbestos Cement Co Ltd sold an asbestos mine to the Cyprus Asbestos Mines Ltd in which the TAC Ltd held 25 per cent of the issued capital. The mine was sold for £182,000 but the sale was not submitted to a general meeting of TAC for approval. The claimant, who was a minority shareholder in TAC, claimed that the defendant directors were negligent because the mine was worth £1,000,000, and this price or something like it should have been obtained. He sued the directors with the company as a nominal defendant for a declaration that the directors were in breach of duty, and for an enquiry into the damage caused to TAC by their negligence and for payment of that sum by the directors to TAC. On the preliminary point as to the competence of the claimant as a minority shareholder to bring a derivative action in these circumstances, it was *held* – by Danckwerts J – that the action was not maintainable because the sale was *intra vires* and, since no acts of a fraudulent character were alleged by the claimant, the sale could be approved by the majority of shareholders and it was a matter for them.

Comment

(i) The claimant was alleging negligence which is a common law claim and derivative actions are creatures of equity, the judiciary being reluctant to extend them to common law claims such as negligence.

(ii) This line of reasoning was followed in ***Multinational Gas* v *Multinational Gas Services*** [1983] 2 All ER 563 where two judges in the Court of Appeal were of opinion that a claim for negligent mismanagement could not be brought even by a liquidator against directors whose actions had been approved by a majority of the members who were not a disinterested majority because they had appointed the directors as their nominees.

Daniels* v *Daniels [1978] 2 All ER 89

Mr Douglas Daniels, Mr Gordon Daniels and Mrs Soule, three minority shareholders in Ideal Homes (Coventry) Ltd, wished to bring an action against the majority shareholders (who were also the directors), Mr Bernard Daniels, Mrs Beryl Daniels and the company. In their claim the minority alleged that in October 1970 Ideal Homes, acting on the instructions of the majority shareholders, sold and conveyed freehold property in Warwick to Mrs Beryl Daniels for £4,250 when they knew, or ought to have known, that the correct value of the land was higher. The majority, in reply to these allegations, said that they adopted a valuation made for probate purposes in June 1969 on the occasion of the death in that month of Mr Joseph Daniels, the father of the minority shareholders and Mr Bernard Daniels. Against this the minority shareholders alleged that probate valuations were conservative as to amount and usually less than the value obtainable on open market between a willing seller and buyer.

In 1974 the land was sold by Mrs Daniels for £120,000 and although the majority had every intention of denying the allegations, they asked at this stage that the claim of the minority be struck out as disclosing no reasonable cause of action or otherwise as an abuse of the process of the court. It was argued, on behalf of the majority, that since the minority was not alleging fraud against the majority no action on behalf of the alleged loss to the company could be brought because under the decision in ***Foss* v *Harbottle***, 1843 the court could not interfere in the internal affairs of the company at the request of the minority. The minority said they were unable to allege fraud because they were not able to say precisely what had happened beyond the matters set out in their claim.

Templeman J, who had not been asked to try the action but only to say whether there was an action at all, reviewed the decisions under the rule in ***Foss* v *Harbottle***, 1843 and his judgment made clear that if the breach of duty alleged turned out to be a breach of fiduciary duty, then it should be allowed to proceed under the rule in ***Cook* v *Deeks***, 1916 because the majority could control general meetings. Furthermore, if the breach of duty alleged was one of skill and care, i.e. negligence at common law, then it should also be allowed to proceed as an exception to ***Foss* v *Harbottle***, 1843 because the alleged negligence had resulted in a profit to one of the directors which distinguished this case from ***Pavlides* v *Jensen***, 1956.

Procedural aspects

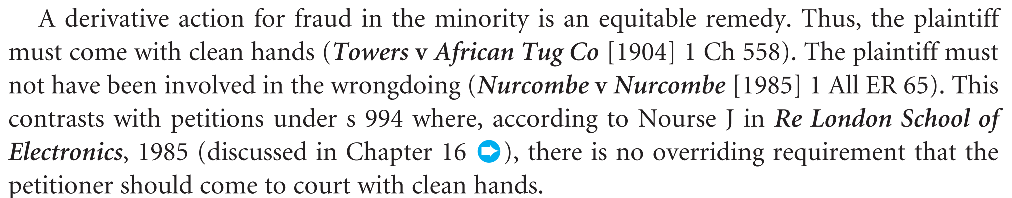
When a shareholder is suing to restrain the majority from acting illegally or continuing to commit a personal wrong upon him he has a choice. He may sue in his own name or in the representative form on behalf of himself and other shareholders with whom he enjoys the right allegedly denied to him. The relief asked for will normally be a *declaratory judgment* saying what the law is and by which the parties intend to abide, or an *injunction* to restrain the conduct complained of if it is thought the majority will still continue to act unfairly.

Where the individual member is seeking a claim against third parties for the company's benefit so that he is trying to enforce a claim which belongs to the company, his claim is called *derivative*.

In a *personal* or *representative* claim the company is a real and genuine defendant. In a *derivative* action the company is joined as a nominal defendant because the directors and the majority of the members of the company will not bring the company into court as a claimant. The company is made a party to the action so that the judge may grant it a remedy by being brought in as a nominal defendant, the claimant naming the company as a defendant in his claim form.

The remedy of damages is available in a derivative claim. The damages go to the company and not to the claimant. However, the claimant is entitled to an indemnity for his costs from the company (***Wallersteiner* v *Moir (No 2)*** [1975] 1 All ER 849).

A derivative action is not available to challenge the form in which a company's accounts are prepared. The Companies Act requires the appointment of auditors who must report upon the accounts and this is the protection which statute law gives to the exclusion of other remedies (***Devlin* v *Slough Estates Ltd*** [1982] 2 All ER 273). It should be noted, however, that the courts may distinguish the ***Devlin*** case and intervene where the company concerned has taken advantage of the audit exemption.



A derivative action for fraud in the minority is an equitable remedy. Thus, the plaintiff must come with clean hands (***Towers* v *African Tug Co*** [1904] 1 Ch 558). The plaintiff must not have been involved in the wrongdoing (***Nurcombe* v *Nurcombe*** [1985] 1 All ER 65). This contrasts with petitions under s 994 where, according to Nourse J in ***Re London School of Electronics***, 1985 (discussed in Chapter 16), there is no overriding requirement that the petitioner should come to court with clean hands.

See p. 326

The rule in ***Foss*** is a *rule of procedure*. It is a matter to be decided *before* the trial of the allegations as to whether the claimant can be allowed to proceed to a trial under an exception to the rule.

There is a firm statement to this effect by the Court of Appeal in ***Prudential Assurance* v *Newman (No 2)*** [1982] 1 All ER 354 where the court was critical of the approach of the trial judge in taking evidence in proof of the allegations for many days and at great cost to the defendants before deciding that a claim could proceed as an exception to ***Foss***.

Prudential Assurance Co Ltd* v *Newman Industries Ltd (No 2) [1982] Ch 204, CA

Cumming-Bruce, Templeman and Brightman LJ took it in turns to read the following judgment of the Court of Appeal:

> It is commonly said that an exception to the rule in ***Foss* v *Harbottle*** arises if the corporation is 'controlled' by persons implicated in the fraud complained of, who will not permit the name of the company to be used as plaintiffs in the suit: see ***Russell* v *Wakefield Waterworks Co*** (1875) LR 20 Eq 474, 482. But this proposition leaves two questions at large, first, what is meant by 'control', which embraces a broad spectrum extending from an overall absolute majority of votes at one end, to a majority of votes at the other end made up of those likely to be cast by the delinquent himself plus those voting with him as a result of influence or apathy. Secondly, what course is to be taken by the court if, as happened in ***Foss* v *Harbottle***, in the ***East Pant Du*** case and in the instant case, but did not happen in ***Atwool* v *Merryweather***, the court is confronted by a motion on the part of the delinquent or by the company, seeking to strike out the action? For at the time of the application the existence of the fraud is unproved. It is at this point that a dilemma emerges. If, upon such an application, the plaintiff can require the court to assume as a fact every allegation in the statement of claim, as in a true demurrer, the plaintiff will frequently be able to outmanoeuvre the primary purpose of the rule in ***Foss* v *Harbottle*** by alleging fraud and 'control' by the fraudster. If, on the other hand, the plaintiff has to prove fraud and 'control' before he can establish his title to prosecute his action, then the action may

need to be fought to a conclusion before the court can decide whether or not the plaintiff should be permitted to prosecute it. In the latter case the purpose of the rule in ***Foss*** **v** ***Harbottle*** disappears. Either the fraud has not been proved, so *cadit quaestio*; or the fraud has been proved and the delinquent is accountable unless there is a valid decision of the board or a valid decision of the company in general meeting, reached without impropriety or unfairness, to condone the fraud [. . .]

We desire, however, to say two things. First, as we have already said, we have no doubt whatever that Vinelott J erred in dismissing the summons of 10 May 1979. He ought to have determined as a preliminary issue whether the plaintiffs were entitled to sue on behalf of Newman by bringing a derivative action. It cannot have been right to have subjected the company to a 30-day action (as it was then estimated to be) in order to enable him to decide whether the plaintiffs were entitled in law to subject the company to a 30-day action. Such an approach defeats the whole purpose of the rule in ***Foss*** **v** ***Harbottle*** and sanctions the very mischief that the rule is designed to prevent . . .

The second observation which we wish to make is merely a comment on Vinelott J's decision that there is an exception to the rule in ***Foss*** **v** ***Harbottle*** whenever the justice of the case so requires. We are not convinced that this is a practical test, particularly if it involves a full-dress trial before the test is applied. On the other hand, we do not think that the right to bring a derivative action should be decided as a preliminary issue upon the hypothesis that all the allegations in the statement of claim of 'fraud' and 'control' are facts, as they would be on the trial of a preliminary point of law. In our view, whatever may be the properly defined boundaries of the exception to the rule, the plaintiff ought at least to be required before proceeding with his action to establish a prima facie case (i) that the company is entitled to the relief claimed, and (ii) that the action falls within the proper boundaries of the exception to the rule in ***Foss*** **v** ***Harbottle***. On the latter issue it may well be right for the judge trying the preliminary issue to grant a sufficient adjournment to enable a meeting of shareholders to be convened by the board, so that he can reach a conclusion in the light of the conduct of, and proceedings at, that meeting.

The statutory derivative action

The new action is found within ss 260–264 of the Companies Act 2006. It is worth noting though that in the Explanatory Notes to the CA 2006, it is noted that 'the sections in this Part do not formulate a substantive rule to replace the rule in ***Foss*** **v** ***Harbottle***, but instead reflect the recommendations of the Law Commission that there should be a "new derivative procedure with more modern, flexible and accessible criteria for determining whether a shareholder can pursue an action" (Shareholder Remedies, paragraph 6.15).' However, in ***Stainer*** **v** ***Lee*** [2010] EWHC 1539 (Ch), Roth J stated: 'The jurisdiction governing derivative claims in England and Wales is now comprehensively governed by Chapter 1 of Part 11 of the Act: sections 260–264. Such claims may be brought only under the provisions in that chapter or pursuant to a court order in proceedings on an "unfair prejudice" petition under section 994; section 260(2).'

Section 260(1) defines a derivative claim as '[. . .] proceedings 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'. Accordingly, there are three elements to the derivative claim: the action is brought by a member of the company; the cause of action is vested in the company; and relief is sought on the company's behalf. With respect to the term 'member', while this is defined in s 112 of the 2006 Act, s 260(5) extends the scope of this to include 'a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law'. This would include, for example, where a trustee in bankruptcy or the personal