Kings Young Professionals Seminar Series

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Unfair Prejudice: Practical Tips

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Section 994 of the Companies Act 2006 ("CA")

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(1) A member of a company may apply to the court by petition for an order under this Part on the ground—

(a) 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 (including at least himself), or

(b) that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.

(1A) For the purposes of subsection (1)(a), a removal of the company's auditor from office—

(a) on grounds of divergence of opinions on accounting treatments or audit procedures, or

(b) on any other improper grounds,

shall be treated as being unfairly prejudicial to the interests of some part of the company's members.

(2) The provisions of this Part apply to a person who is not a member of a company but to whom shares in the company have been transferred or transmitted by operation of law as they apply to a member of a company.

(3) In this section, and so far as applicable for the purposes of this section in the other provisions of this Part, "company" means—

(a) a company within the meaning of this Act

The Dispute Walks Through Your Door

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- If acting from the Petitioner, you are generally in a strong position with because the end point is probably going to be that someone buys your shares.
- But you must check that the person you are instructed by does actually own shares in the company.
- In theory, the starting point is that there should be a register of members (CA, s.113(1)) and a person becomes a member of the company by being entered in the register of members (CA, s.112(2)) but many private companies do not adhere to this rule.
- To simplify this, chapter 2A was introduced into part 8 of the CA to allow for private limited companies to elect to have the information as to membership kept on the central register (Companies House).

- Petitioners' representatives also need to sense check a case.
- Does the client want to sell their shares? Pulling the trigger on an unfair prejudice petition is likely to put you on a one-way track to shares being sold.
- Is there really something unfairly prejudicial about what has happened or have they just fallen out? Be wary of the client who is just unhappy with the other shareholders for personal reasons rather than for unfair prejudice reasons.
- Is the client's valuation of the company sensible? Petitioners can come unstuck because they believe that a company has a value which is simply unrealistic.

- Acting for the Respondent shareholders is inherently difficult because the relationship between the parties has probably already descended to a level where they want rid of the Petitioner.
- In that scenario, the Respondents are probably going to buy out the Petitioner at some stage and, in small private companies, the costs involved in a petition will swiftly become disproportionate to the value of the company.
- A swift settlement is therefore likely to be the cheapest deal available in a lot of cases.

O'Neill v Phillips Offers

- The strongest tool in a Respondent's bag is a reasonable offer to buy out the Petitioner.
- The principles for this were set out by Lord Hoffmann in *O'Neill v Phillips* [1999] 2 BCLC 1.
- This is an open offer which can (in some circumstances) enable a respond to secure summary dismissal of a petition.

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*"**In the first place, the offer must be to purchase the shares at a fair value**. This will ordinarily be a value representing an equivalent proportion of the total issued share capital, that is, **without a discount for its being a minority holding.** The Law Commission (paras 3.57 to 3.62) has recommended a statutory presumption that in cases to which the presumption of unfairly prejudicial conduct applies, the fair value of the shares should be determined on a pro rata basis. This too reflects the existing practice. This is not to say that there may not be cases in which it will be fair to take a discounted value. But such cases will be based upon special circumstances and **it will seldom be possible for the court to say that an offer to buy on a discounted basis is plainly reasonable, so that the petition should be struck out.**"*
(Emphasis added)

*"Secondly, **the value, if not agreed, should be determined by a competent expert**. **The offer in this case to appoint an accountant agreed by the parties or in default nominated by the President of the Institute of Chartered Accountants satisfied this requirement.** One would ordinarily expect the costs of the expert to be shared but he should have the power to decide that they should be borne in some different way."*
(Emphasis added)

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*"Thirdly, **the offer should be to have the value determined by the expert as an expert**. I do not think that the offer should provide for the full machinery of arbitration or the half-way house of an expert who gives reasons. The objective should be economy and expedition, even if this carries the possibility of a rough edge for one side or the other (and both parties in this respect take the same risk) compared with a more elaborate procedure."*

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"Fourthly, the offer should, as in this case, provide for equality of arms between the parties. ***Both should have the same right of access to information about the company which bears upon the value of the shares and both should have the right to make submissions to the expert****, though the form (written or oral) which these submissions may take should be left to the discretion of the expert himself."*

"Fifthly, there is the question of costs. In the present case, when the offer was made after nearly three years of litigation, it could not serve as an independent ground for dismissing the petition, on the assumption that it was otherwise well founded, without an offer of costs. ***But this does not mean that payment of costs need always be offered.*** *If there is a breakdown in relations between the parties,* ***the majority shareholder should be given a reasonable opportunity to make an offer (which may include time to explore the question of how to raise finance) before he becomes obliged to pay costs.*** *As I have said, the unfairness does not usually consist merely in the fact of the breakdown but in failure to make a suitable offer. And the majority shareholder should have a reasonable time to make the offer before his conduct is treated as unfair. The mere fact that the petitioner has presented his petition before the offer does not mean that the respondent must offer to pay the costs if he was not given a reasonable time."* (Emphasis added)

But it must be remembered:

1. An *O'Neill v Phillips* offer can be difficult to formulate if there is a dispute about whether money was legitimately extracted from a company.
2. The offer must be open if you want to be able to rely upon it for summary disposal.
3. The offer is not a part 36 offer, so it will not carry part 36 consequences. You might, therefore, want to make a part 36 offer alongside it.

Valuing the shares

To discount or not to discount? There is some contradictory authority here:

- The shares will not be discounted for being a minority shareholding if it is a quasi-partnership but will be discounted if they were originally acquired with a minority discount – *Re Bird Precision Bellows Ltd* [1984] Ch 419
- Shares will be valued at a minority discount unless there is a quasi-partnership or some other good reason to attribute a pro rata value – *Irvine v Irvine* [2006] 4 All ER 102

- Where the company is not a quasi-partnership, the court will apply a minority discount but then to add back in a "marriage value" for the fact that the Respondents would be acquiring combined holdings in excess of 75% - *Re Edwardian Group Ltd* [2019] 1 BCLC 171
- The starting point is that there will be no minority discount unless the shares were bought at a minority discount originally - *Re Blue Index Ltd* [2014] EWCH 2680 (Ch)

Quasi-Partnership

- In general, members have no legitimate expectations beyond the legal rights conferred on them by the constitution of the company (*Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14.
- But a legitimate expectation to be involved in the management of the company may arise in a quasi-partnership.

- Quasi-partnership will have two principle impacts on a petition.

1. Lawful exclusion from management may, in and of itself, by unfairly prejudicial.
2. It may be relevant to whether a minority discount applies.

- The House of Lords identified the following elements of a quasi-partnership in *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 (per Lord Wilberforce):

  "i) an association formed or continued on the basis of a personal relationship, involving mutual confidence - this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some (for there may be 'sleeping' members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members' interest in the company - so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere."

- The most common bar to a quasi-partnership arrangement will be the existence of a shareholders' agreement setting out the parties' respective rights and obligations in respect of the management of a company. Whilst the existence of an agreement or understanding is fundamental to a quasi-partnership, the more formal that agreement is, the less likely it is that there will be a quasi-partnership.
- Companies can start off as quasi-partnerships but then lose that quality as they grow and the membership expands or where the relationship is subsequently formalised in a shareholder agreement.

- It is possible in some circumstances for there to be a quasi-partnership between some shareholders but not others (*Fisher v Cadman* [2006] BCLC 499) but this is unusual because those who are not party to the understanding have a right to see the company managed in accordance with the legal powers and duties imposed by the articles and the law, not in accordance with some understanding to which they are not party (*Re Edwardian Group Ltd* at [136]).

Unfair Prejudice Petition Practice

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- A s.994 claim is commenced by petition rather than by claim form.
- The practice is generally to include the points of claim within the petition and, at the first hearing, seek a direction that the petition stand as the points of response.
- In a case where urgent interim relief was sought, it may be appropriate to present a shorter form of petition and seek a direction for further points of claim to be filed at a later date.
- The Companies (Unfair Prejudice Applications) Proceedings Rules 2009 ("the 2009 Rules"), r.4 requires that the petition be served on the company and the other respondents not less than 14 days before the return day listed on presentation.

- However, in the Rolls Building automatic directions will be given directing service of the petition within 14 days of “issue” and for the petition to stand as points of claim with a further direction then for points of defence and points of reply and a listing thereafter for case management (and, most likely, costs management).
- Aside from express variations in the 2009 Rules, the CPR applies.

Thank you for attending

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- You can follow Kings Chambers (and most of its barristers) on Twitter and LinkedIn.
- The next talk in our series will be from Nick Taylor dealing with the thorny issue of good faith in contracts. Chelsea Carter will be speaking in the new year about applications under ss.238 and 239 of the Insolvency Act 1986.