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# A Practical Guide to Unfair Prejudice Petitions and their interaction with Derivative Claims

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## Unfair Prejudice Petitions

### Introduction

1. A minority oppressed by a majority can petition the court to wind up a company on the basis that it is just and equitable to do so<sup>1</sup>. It may be thought that the minority does not want to take this course of action, particularly if the company is viable and profitable. Therefore, to obtain redress, a member of a company can make an unfair prejudice petition to the court under s994(1) Companies Act 2006 ('the Companies Act').

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<sup>1</sup> S122(1)(g) Insolvency Act 1986

## **What is an Unfair Prejudice Petition?**

2. An unfair prejudice petition is usually a remedy for minority oppression, especially within smaller companies such as unlisted small and medium sized enterprises ('SME'). However, the remedy provided by s994 is not confined to minority shareholders. Equal shareholders and those in a majority, but where a minority has a controlling position, may bring petitions<sup>2</sup>. The court will not grant a majority a remedy under s994 where the prejudice is one which a majority shareholder can rid himself of by using his majority shareholding<sup>3</sup>.
  
3. The grounds for bringing a petition are<sup>4</sup>:

“the company’s affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of members generally or some part of its members (including at least himself) or that any actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial”

The inclusion of the words ‘including at least himself’ means that a member cannot petition unless his interests have been adversely affected by the unfairly prejudicial conduct.

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<sup>2</sup> Ravenheart Service (Holdings) Ltd, Re [2004] 2 BCLC 376; Stewarts (Brixton) Ltd, Re [1985] BCLC 4

<sup>3</sup> Legal Costs Negotiators Ltd, Re [1999] 2 BCLC 171, CA

<sup>4</sup> ss994(1) and 995(2)

4. There are therefore 2 grounds for an unfair prejudice petition:

- 4.1. Conduct of the affairs of the company in an unfairly prejudicial manner;  
and
- 4.2. A corporate act or omission which is or would be unfairly prejudicial.

Either is enough as a ground for a petition, although often both elements will be present. Proposed acts are encompassed by the section, but mere fears about how a company's affairs may be conducted would not be enough and a petition on such a basis would likely be found to be premature<sup>5</sup>. Failure by those in control of a company to exercise the powers vested in them may constitute conduct of the affairs of a company<sup>6</sup>.

### **Who can bring an Unfair Prejudice Petition?**

5. A member may bring an unfair prejudice petition. A member is defined in the Companies Act as a subscriber to the memorandum and as any other person who agrees to become a member of the company and whose name is entered on the register of members<sup>7</sup>. This includes nominee shareholders<sup>8</sup>. A person with a beneficial interest in a share but is not a registered member cannot bring a petition<sup>9</sup>. However, the interests of a beneficial owner may be protected under s994 if the nominee shareholder decides either voluntarily or on instruction to bring a petition.

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<sup>5</sup> Astec (BSR) Plc, Re [1998] 2 BCLC 556

<sup>6</sup> Whillock v Henderson [2009] BCC 314

<sup>7</sup> s112 Companies Act 2006

<sup>8</sup> Brightview Ltd, Re [2004] BCC 542

<sup>9</sup> ibid

6. This concept of membership is then extended in s994 in two ways. Firstly, membership is extended to mean those to whom shares have been transferred but whose names have not been entered in the register of members<sup>10</sup>. Secondly, it is extended to those to whom shares have been transmitted by operation of law, e.g. upon the death of a member, and whose names have not been entered in the register.
7. However, for a petition to be successful there must have been conduct that is unfairly prejudicial to the interest of some or all of the members of the company including the petitioner's interests. The conduct need not affect the interest of petitioners in their capacity as members as long as it is sufficiently connected with membership. In Re a Company<sup>11</sup>, it was held that the exclusion of a member from the board of directors amounted to unfair prejudice. Similarly, in Tay Book Shoon v Tahansan<sup>12</sup>, it was held that a non-executive chairman did have an interest in remaining in post to protect the capital he had contributed by way of loans to the company.

### **What is Unfair Prejudice?**

8. It has been held that the test for unfair prejudice is an objective test not a subjective one<sup>13</sup>. It would not therefore be necessary to show that the majority acted in the

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<sup>10</sup> This applies where shares are held in paper form and a proper instrument of transfer has been executed and delivered to the transferee or company: See Company A (No. 003160 of 1986) [1986] BCLC 391

<sup>11</sup> [1986] BCLC 213

<sup>12</sup> [1987] 1 WLR 413 PC

<sup>13</sup> Bovey Hotel Ventures Ltd, Re, unreported but the relevant section of that judgment is set out at [1983] BCLC 290. The view was followed by Nourse J in RA Noble & Sons (Clothing) Ltd [1983] BCLC 273

knowledge that the conduct would prejudice the petitioner. The question is whether a reasonable man would regard the conduct as having unfairly prejudiced the minority's interests.

9. It is important to note too that there is unlikely to be an entitlement to a remedy in an unfair prejudice petition if there has been no breach of the terms on which it has been agreed by the petitioner that the affairs of the company will be conducted<sup>14</sup>.
10. An unfair prejudice petition will succeed if the two constituent parts of unfair prejudice are established, namely unfairness and prejudice. In the case of Jesner v Jarrard Properties<sup>15</sup>, it was held that conduct that prejudices the petitioner may not necessarily be unfair. The case involved two companies run as a single entity with little or no regard paid to the constitutional provisions of either of them. This was not unfair because the petitioners had known and agreed to or acquiesced in this arrangement.
11. Conduct may also be unfair but not prejudicial. In Rock Nominees v RCO Holdings<sup>16</sup>, a company acquired assets where the directors were in a position of conflict of interest. It was found that the conduct was unfair but that the petitioners had suffered no prejudice as the price paid for the assets was the price that would have been paid had no conflict existed.
12. If prejudice is found by the court it needs to be substantial relative to the remedy claimed. For example, a respondent was not required to buy out a petitioner's

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<sup>14</sup> Saul D Harrison and Sons, Re [1995] 1 BCLC 14

<sup>15</sup> [1992] BCC 807

<sup>16</sup> [2004] 1 BCLC 439, CA

shares where the prejudice was trivial and the petitioner had accepted the role of passive investor<sup>17</sup>.

### Legitimate Expectations

13. The interests that the courts may be prepared to protect in an unfair prejudice petition are commonly referred to as legitimate expectations. It has been held that members have a legitimate expectation that a company will be managed lawfully, which in this context means in accordance with the articles or duties of the directors.

14. However, where the arrangements between members are informal and unwritten, legitimate expectation arising from unwritten understanding may still be found, albeit it is less likely<sup>18</sup>. In larger companies, it is unlikely that the court will find that a legitimate expectation based on an informal arrangement existed and even less likely that it will give effect to it<sup>19</sup>.

### Equitable Considerations

15. The term 'legitimate expectations' was coined by Hoffman J, as then was. However, in the House of Lords, he later reined back on the importance of the concept, saying in O'Neill v Phillips<sup>20</sup> that the term 'should not be allowed to lead a life of its own'. What he attempted to achieve in that judgment was an end to the courts having a perceived general remit to assess the fairness of the actions of the controllers of

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<sup>17</sup> Metroplis Motorcycles Ltd, Re [12005] 1 BCLC 520

<sup>18</sup> A Company (2015 of 1996), Re [1997] 2 BCLC 1

<sup>19</sup> Blue Arrow, re [1987] BCLC 585

<sup>20</sup> [1999] 1 WLR 1092, HL

companies. His preference was to use the phrase 'equitable considerations' to characterise the basis on which the courts should intervene where there was unfair prejudice.

16. It may not be immediately obvious to practitioners that there is much practical difference between the two approaches and most academic commentators have observed as much<sup>21</sup>. However, what the case does emphasise is that the courts will adopt an almost contractual approach to assessing whether or not a legitimate expectation has been met. This approach means that the courts will pay detailed attention to the development of relations between the shareholders in order to establish whether understandings have developed on which legitimate expectation or equitable considerations can be based which the court should protect<sup>22</sup>.

17. The case law after O'Neill uses equity and fairness often interchangeably. Judges have also employed notions of good faith to determine whether a minority has been unfairly prejudiced. In Re Guidezone Ltd<sup>23</sup>, Jonathan Parker J held that unfairness may be tested by using equitable principles and establishing the actions of the majority were such as to be contrary to good faith. The process will usually involve needing to prove the existence of agreements, promises or undertakings reached among shareholders at the outset of the company's existence or later and that there was reliance on those understandings.

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<sup>21</sup> e.g. see Palmer's Company Law, 8.3819

<sup>22</sup> [1999] 1 WLR 1092, HL

<sup>23</sup> [2000] BCLC 321

## **Derivative Claims**

18. The petitioner in an unfair prejudice is, ordinarily, seeking personal relief. If a petitioner seeks relief for the company then the petition is in effect being used to bring a derivative action. ss262 and 265 of the Companies Act establish that a derivative action may only be brought through the procedure set out at Pt II of the Companies Act or by way of a court order made as a remedy after a successful unfair prejudice petition has been brought.
19. On the face of the statutory provisions it would appear that to allow corporate relief to be obtained directly in an unfair prejudice petition would undermine the careful procedural safeguards established by Pt II of the Companies Act. However, exceptions exist and it may be possible in certain circumstances for a petitioner to bring a derivative claim by way of a s994 petition<sup>24</sup>.
20. In a case where a derivative claim had been brought, a shareholder was given leave to join an unfair prejudice petition to the derivative claim. The derivative was though then stayed on the basis that the petition would allow the court to decide the dispute between the parties. This was held to be a convenient approach because the petition was based on allegations of breach of duty on the part of the majority as well as allegations of unfairness<sup>25</sup>.

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<sup>24</sup> Bhullar v Bhullar [2004] 2 BCLC 241

<sup>25</sup> Cooke v Cooke [1997] 2 BCLC 28



## **Remedies**

21. The courts powers are wide if it finds in favour of a petitioner in an unfair prejudice petition. The general power is expressed as:

“such order as it [the court] thinks fit for giving relief in respect of the matter complained of”

More specifically, the courts powers may<sup>26</sup>:

- Regulate the conduct of the company's affairs in the future;
- Require the company to refrain from doing or to do an act whose commission or omission the petitioner has complained of;
- Authorise civil proceedings to be brought in the company's name by such persons and on such basis as the court may direct;
- Require the company not to make any or any specified alterations to its articles without the leave of the court;
- Provide for the purchase of any shares of any members of the company by other members or the company itself (s996(2))

22. The most common remedy is for the court to order that the petitioner's shares in the company be bought by the majority. As a result, it is often the valuation

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<sup>26</sup> See Palmer's Company Law, 8.3804

evidence of the parties' experts that consumes much of the time at trial. A number of points emerge from the case law on valuation and remedies:

- a) Generally, the shares of a minority shareholder will be valued at a discount to reflect the lack of control. However, where a quasi partnership exists this does not apply<sup>27</sup>.
- b) If the conduct of the majority has adversely affected the value of the company, the court may order that the shares of the minority are bought at a valuation that reflects the valuation of the company prior to that conduct or on an assumption that the conduct did not occur<sup>28</sup>.
- c) The court will make an assessment as to the valuation of the company at the date of the hearing and not at the date of the petition. It is also possible that the court will take into account conduct that has occurred after the petition has been presented.

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<sup>27</sup> Irvine v Irvine (No 2) [2007] 1 BCLC 445

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## **Practice and Procedure – How to bring an Unfair Prejudice Petition and what to expect procedurally**

### Petition

23. Except insofar as incompatible with the Companies Act, the CPR generally applies to unfair prejudice petitions<sup>29</sup>. There are though specific requirements for the petition and service set out in the Companies (Unfair Prejudice Applications) Proceedings Rules 2009, SI 2009/2469.

24. A s994 application requires a petition. Proceeding in any other way is a procedural defect that cannot be remedied under the CPR. The petition must specify the grounds on which it is presented and the nature of the relief which is sought by the Petitioner (i.e. the shareholder who is bringing the claim).

25. The court must fix a hearing for a day (the 'return day') on which, unless the court otherwise directs, the petitioner and any respondent, including the company, must attend before the registrar or district judge for directions to be given in relation to the procedure on the petition. On fixing the return day, the court must return to the petitioner sealed copies of the petition for service, each endorsed with the return day and the time of hearing.

26. The petitioner must, at least 14 days before the return day, serve a sealed copy of the petition on the company. In the case of a petition by a member of the company,

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<sup>29</sup> See CPR Practice Direction 49A

the petitioner must also, at least 14 days before the return day, serve a sealed copy of the petition on every respondent named in the petition<sup>30</sup>. On the return day, or at any time after it, the court must give such directions as it thinks appropriate.

27. Interlocutory relief may be available to protect the Company's and the Petitioner's position pending the hearing of the petition, although the court will not grant relief presupposing that unfair prejudice will be found at trial<sup>31</sup>.

### Respondents

28. Ordinarily the respondent to a petition will be the majority shareholder oppressing the minority shareholder. However, the range of potential respondents is broader. A former member of the company may be respondent<sup>32</sup>. It is even possible to obtain relief against an individual who is not and has never been a member or director of the company that is the subject of the petition, where that individual has knowingly received or improperly assisted in the wrongful diversion of assets of the company<sup>33</sup>.

29. The Company will often be named as a respondent. This is because it may be the case that the company will be required to purchase assets or shares.

### Limitation

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<sup>30</sup> Companies (Unfair Prejudice Applications) Proceedings Rules 2009, SI 2009/2469, r 4(2).

<sup>31</sup> Re a Company (No 004175 of 1986) [1987] 1 WLR 585. In Pringle v Callard [2007] EWCA Civ 1075, [2008] 2 BCLC 505, the Court of Appeal held that when considering the grant of an interim remedy on a petition under the Companies Act 2006 s 994, the court must consider: (1) whether there is a serious issue to be tried; and (2) if there is, then whether there is an adequate remedy for the petitioner (case decided under the Companies Act 1985 s 459, where the interim relief sought was an injunction to prevent one of the directors being removed from her position)

<sup>32</sup> Little Olympian Each Ways Ltd (No.3), Re [1995] 1BCLC 636

<sup>33</sup> Lowe v Fahey [1996] 1 BCLC 262 at 268

30. There is no limitation period applicable to unfair prejudice petitions, but in keeping with the 'equitable' approach of the court, where there has been excessive delay the courts are less likely to grant relief<sup>34</sup>.

### Preliminary hearings

31. The preliminary hearings in an unfair petition will likely involve directions / orders relating to disclosure and expert valuation evidence. Disclosure will be important in that the majority will often have control of the physical documents and / or electronic data which will be relevant to the case. It is therefore often the case that there will be dispute as to what should and should not be disclosed and the court's assistance on disclosure will be required. As noted above the expert valuation evidence will be critical in determining the value of the minority's shareholding, the purchase of which is the common remedy in a successful petition. The order will therefore normally make provision for an expert or experts to provide valuations of the company and its shares.

### Conclusion

32. These types of disputes typically involve companies with a small number of shareholders. In all probability they will have fallen out with each other. The basis of or manner in which they have fallen out gives rise to a wide range of factual backgrounds to such cases. However, the breadth of the courts powers means that the court can respond appropriately to the diverse factual backgrounds to the

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<sup>34</sup> Granactual, Re [2006] BCC 73 – the relief sought in that case related to events that occurred 9 years before the petition was brought

dispute. This may involve control of the affairs of the company and / or ordering the sale of the shares at a price determined by the court.

33. The cost of reaching that stage is high and courts will encourage ADR. In a recent hearing before a Companies Court, the judge put himself forward for early neutral evaluation as well as suggesting mediation. Parties will be expected to have considered ADR and will need good reason for not participating in some form of ADR.

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## **Recent Case Law**

### Recent Unfair Prejudice Petition cases

34. Arbuthnott v Bonnyman [2015] EWCA Civ 536: unfair prejudice remedy sought (unsuccessfully) to challenge the exercise of rights under the articles by the majority shareholders. This case confirms the circumstances in which an alteration to a company's articles may be challenged as invalid.
35. Thomas v Dawson [2015] EWCA 706: highlights how wide the discretion conferred on the court is when ordering relief under s.994. The Company was balance sheet insolvent, but the court ordered that the petitioner be granted an option to purchase the majority's shares at a fixed price and be permitted to continue to have conduct of the management of the company.
36. Re BC&G Care Homes Ltd; subnom Crowley v Bessell and others [2015] All ER (D) 115 (Jun) involved a quasi- partnership and the available remedies in those circumstances. It contains a helpful recap of the relevant authorities. The court held that in the circumstances, the removal of the petitioner's right to be involved in the management of the company was unfair in the absence of a fair offer to acquire his shares.
37. Birdi v Specsavers Optical Group Ltd & Ors [2015] EWHC 2870 demonstrates the impact of wrongdoing on a fair valuation of shares. The court ordered that the price

payable for a petitioner's shares should include a sum to make good the prejudice that has been unfairly suffered by Mrs Birdi, even though the prejudice did not depress the value of the company or Mrs Birdi's shares.

### Useful Older Cases

38. Nuneaton Borough AFC Ltd, Re [1989] 5 BCC 377: Definition of a member
39. A Company (no. 007281 of 1986) [1987] 3 BCC 375: Who should be joined in the petition
40. North Holdings Ltd v Southern Tropics Ltd [1999] 2 BCLC 625: Courts will encourage early expert valuation on a joint basis to promote the chances of settlement and the avoidance of costs
41. A Company, Re (No. 00596 of 1986) [1986] 2 BCC 99: Interim relief not available under s996 Companies Act 1996, but court may grant relief on American Cyanamid principles including appointment of interim receiver.
42. Arrow Trading v Edwardian Group [2003] EWHC 2863: Not normally proper for respondents to use company funds to defend position
43. Saul D Harrison & Sons Plc, Re [1995] 1 BCLC 14: Unfairness to be understood by ordinary meaning of the word. Keeping promises and honouring agreement are 'watchwords'.



44. Sikorski v Sikorski [2012] EWHC 1613: No limit to the type of order court may make to give relief

45. Sethi v Patel [2010] EWHC 1830: Buy out price to be fair. It may take into account the reduction in value of the business as a result of the unfair prejudicial conduct of the respondent

## **Useful Textbooks, Articles and Sources**

1. Palmer's Company Law, Volume 2, 8.3801–8.3825.1
2. Hollington on Shareholder's Rights
3. Lindley and Banks on Partnership
4. Practical Law - Unfair prejudice petitions under the Companies Act 2006: rights and remedies
5. Halsbury's Laws of England - Volume 14 Paras 1–692;
6. Halsbury's Laws of England - Volume 15 Paras 693–1841
7. Companies (Unfair Prejudice Applications) Proceedings Rules 2009, SI 2009/2469
8. CPR Practice Direction 49A