A practical guide to unfair prejudice petitions

Charlie Newington-Bridges, St John's Chambers

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This guide provides an overview of the principles relating to unfair prejudice petitions. It is not legal advice and should not be relied upon as such. Businesses and individuals should seek bespoke legal advice in respect of their particular positions. This guide is an updated version of a similar guide published in 2019.

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[1]. It may be though that the minority does not want to take this course of action, particularly if the company is viable and profitable. It may also be the case that a winding-up would not reflect the value in the company[2]. 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').

[1] S122(1)(g) Insolvency Act 1986
[2] A winding-up may not capture all the value of a going concern, e.g. the goodwill in a company.

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 ('SMEs'). However, the remedy provided by s994 is not confined to minority shareholders. 50% equal shareholders and those in a majority, but where a minority has a controlling position, may bring petitions[3]. 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[4].

3. The grounds for bringing a petition are[5]:

> "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.

[3] Ravenheart Service (Holdings) Ltd, Re [2004] 2 BCLC 376; Stewarts (Brixton) Ltd, Re [1985] BCLC 4
[4] Legal Costs Negotiators Ltd, Re [1999] 2 BCLC 171, CA
[5] 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 to be found to be premature[6]. Failure by those in control of a company to exercise the powers vested in them may constitute conduct of the affairs of a company[7].

5. The "company's affairs" means that the Court is concerned with whether or not the affairs of the Company have been conducted in a manner that is unfair and prejudicial. A breach of a shareholders' agreement, where the terms of the same governed the terms upon which it was agreed that the affairs of the company would be conducted, is conduct of the company's affairs[8].

Who can bring an Unfair Prejudice Petition?

6. 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

[6] Astec (BSR) Plc, Re [1998] 2 BCLC 556
[7] Whillock v Henderson [2009] BCC 314
[8] Sikorski v Sikorski [2012] EWHC 1613 at [56].

register of members[9]. This includes nominee shareholders[10]. A person with a beneficial interest in a share but is not a registered member cannot bring a petition[11]. 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.

7. 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[12]. 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.

8. 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[13], 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[14], it was held that a non-executive chairman did have an interest in

[9] s112 Companies Act 2006
[10] Brightview Ltd, Re [2004] BCC 542
[11] ibid
[12] 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
[13] [1986] BCLC 213
[14] [1987] 1 WLR 413 PC

remaining in post to protect the capital he had contributed by way of loans to the company.

What is Unfair Prejudice?

9. It has been held that the test for unfair prejudice is an objective test not a subjective one[15]. It would not therefore be necessary to show that the majority acted in the 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.

10. 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[16].

11. 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[17], 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.

[15] 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
[16] Saul D Harrison and Sons, Re [1995] 1 BCLC 14
[17] [1992] BCC 807

12. Conduct may also be unfair but not prejudicial. In Rock Nominees v RCO Holdings[18], 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.

13. Prejudice is almost always economic prejudice: see Michel v Michel [2019] EWHC 1378 (Ch) at [77] – [78]. However, prejudice is not limited to cases where there is/could be a diminution in the value of the shareholding[19]. A breakdown of relationship of trust and confidence as a result of conduct of the affairs of the company has been held to constitute prejudice[20] as has failures of good administration[21].

14. 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 shares where the prejudice was trivial and the petitioner had accepted the role of passive investor[22].

Legitimate Expectations

15. 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

[18] [2004] 1 BCLC 439, CA
[19] Re Coroin [2012] EWHC 2343 at [630] – [631]; see also Hollington at [7-29]
[20] Re Baulmer (UK) Ltd [2005] BCC 181 at [180] – [181]
[21] Re Edwardian Group Ltd [2018] EWHC 1715 (Ch) at [339], [493], [606] and [620]
[22] Metroplis Motorcycles Ltd, Re [12005] 1 BCLC 520

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.

16. 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[23]. 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[24].

Equitable Considerations

17. The term 'legitimate expectations' was coined by Hoffman J, as he then was. However, in the House of Lords, he later reined back on the importance of the concept, saying in O'Neill v Phillips[25] 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 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.

18. It may not be immediately obvious to practitioners that there is much practical difference between the two approaches and most academic commentators have

[23] A Company (2015 of 1996), Re [1997] 2 BCLC 1
[24] Blue Arrow, re [1987] BCLC 585
[25] [1999] 1 WLR 1092, HL

observed as much[26]. 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[27].

19. 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[28], 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.

Quasi-partnership

20. Quasi-partnership is often pleaded in unfair prejudice petitions because if it is established that a quasi-partnership exists no minority discount will be applied to the value of the shares owned by the Petitioner in any buy-out ordered by the court.

[26] e.g. see Palmer's Company Law, 8.3819
[27] [1999] 1 WLR 1092, HL
[28] [2000] BCLC 321

21. A company which exhibits some or all of features identified by Lord Wilberforce in Ebrahimi v Westbourne Grove[29] so as to give rise to the application of equitable principles is usually called a 'quasi-partnership'.

> "The superimposition of equitable considerations requires something more, which typically may include one, or probably more, of the following elements: (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."

22. In practical terms, a quasi-partnership is a company where "the circumstances surrounding the conduct of the affairs of a particular company are such as to give rise to equitable constraints upon the behaviour of other members going beyond the strict rights and obligations set out in the Companies Act and the articles of association"[30].

23. In Re Coroin[31], It was held by Richards J judge that equitable obligations did not exist, in circumstances where "articles of association and a shareholders agreement were negotiated and drafted, containing lengthy and complex provisions" to govern the relationships between members. The more professionally and carefully drafted such agreements are, the less likely that equitable considerations exist, on the basis that the parties intended solely to rely on their strict legal or contractual rights.

[29] [1973] AC 360
[30] [2005] EWHC 377 (Ch) at [84]
[31] [2012] EWHC 2343 (Ch)

Derivative Claims

24. 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.

25. 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[32].

26. 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[33].

[32] Bhullar v Bhullar [2004] 2 BCLC 241
[33] Cooke v Cooke [1997] 2 BCLC 28

Remedies

27. 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[34]:

- Regulate the conduct of he 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))

28. The court has a wide discretion as to remedy and, in particular as to the date of the valuation. The usual date is the date on which the order for purchase is made. Such

[34] See Palmer's Company Law, 8.3804

an order has been described as a starting point: *Profinance Trust SA v Gladstone*[35]. *Re Bird Precision Bellows Ltd*[36] is authority to the effect that the court has discretion to set a purchase price that is fair in all the circumstances, taking into account the merits of the case, including the unfair prejudice suffered. It is therefore the case that in some circumstances, the court will order a valuation date other than the date on which the order for purchase is made.

29. 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 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[37].

    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[38].

[35] [2002] 1 BCLC 141
[36] [1985] 3 All ER 523
[37] Irvine v Irvine (No 2) [2007] 1 BCLC 445
[38]

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.

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

Petition

30. Except insofar as incompatible with the Companies Act, the CPR generally applies to unfair prejudice petitions[39]. There are though specific requirements for the petition and service set out in the Companies (Unfair Prejudice Applications) Proceedings Rules 2009, SI 2009/2469.

31. 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).

32. 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

[39] See CPR Practice Direction 49A

petitioner sealed copies of the petition for service, each endorsed with the return day and the time of hearing.

33. 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, 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[40]. On the return day, or at any time after it, the court must give such directions as it thinks appropriate.

34. 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[41].

Respondents

35. 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[42]. It is even possible to obtain relief against an individual who is not and has never been a member or director of

[40] Companies (Unfair Prejudice Applications) Proceedings Rules 2009, SI 2009/2469, r 4(2).
[41] 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)
[42] Little Olympian Each Ways Ltd (No.3), Re [1995] 1BCLC 636

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[43].

36. 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.

Reasonable Offers

37. It has been held in the leading case on unfair prejudice heard in the House of Lords, *O'Neill v Phillips*[44], that a reasonable offer by the majority to purchase the shares of the minority may prevent the conduct of which the petitioner complains from being unfairly prejudicial to his interests. Lord Hoffman gave guidance in that case as to what constitutes a reasonable offer. He reasoned:

> "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.
>
> 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.

[43] Lowe v Fahey [1996] 1 BCLC 262 at 268
[44] [1999] 2 BCLC1, 16d per Lord Hoffman

> 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. This is in accordance with the terms of the draft regulation recommended by the Law Commission: see App C to the report.
>
> 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."

38. A reasonable offer which meets or adheres to the guidance set out by Lord Hoffman above would likely be a strong defence to any unfair prejudice petition.

Limitation

39. 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[45].

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

Preliminary hearings

40. 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 most 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

41. 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 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.

42. 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.

Charlie Newington-Bridges
charlie.newington-bridges@stjohnschambers.co.uk
St John's Chambers

Useful Textbooks, Articles and Sources

1. Palmer's Company Law
2. Hollington on Shareholder's Rights
3. Minority Shareholders - Law, Practice and Procedure
4. Lindley and Banks on Partnership
5. Practical Law - Unfair prejudice petitions under the Companies Act 2006: rights and remedies
6. Companies (Unfair Prejudice Applications) Proceedings Rules 2009, SI 2009/2469
7. CPR Practice Direction 49A