

# Unfair Prejudice Commercial Insights Webinar Series

Stuart Benzie - Radcliffe Chambers  
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# Unfair Prejudice

- The origins of the minority oppression remedy
- Section 994 Companies Act – fundamental concepts
- Coinomi Holdings Ltd

# Unfair Prejudice – the origins...

Underlying principles can be traced to the sixth Century codification of Roman Law ordered by Emperor Justinian I (See Briggs J in ***Assénagon Asset Management SA v Irish Bank Corpn Ltd*** [2013] Bus. L.R. 266)



Applied in the mid-nineteenth Century to a power given to two thirds of the members of a partnership to expel a partner by notice

***Blisset v Daniel*** (1853) 10 Hare 493

*General principles of ancient origin” which “have been established by English law in relation to the construction and exercise of powers conferred upon a majority to bind a minority within a class”.*

# History of the remedy...

## Section 210 CA 1948

- First attempt at a statutory remedy
- Used the word "oppression"
- Doubt as to whether "oppression" required actual illegality

## Jenkins Committee 1962

- Recognised the problem with the word "oppression"
- Also saw that there was uncertainty as to the scope of the remedy
- Recommended use of term "unfair prejudice"

## Section 456 CA 1985

- Originally s.75 of the 1980 Act
- Adopted the term "unfair prejudice"
- Deliberately imprecise language
- Wide discretion

## Section 994 Companies Act 2006



Companies Act 2006

# Section 994 Companies Act 2006

- (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.



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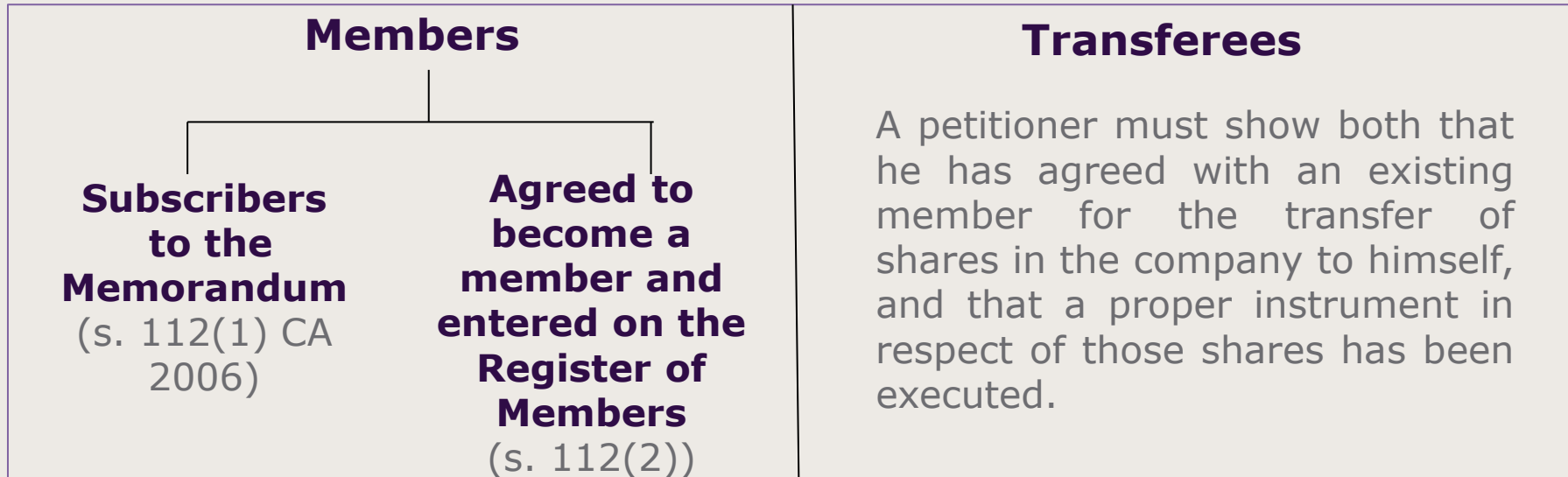
# Section 994 Companies Act 2006

**To be entitled to relief: the Petitioner must prove:**

1. That they are a **member of the company**
2. That the acts or omissions of which they complain are the **management of the affairs of the Company**
3. That the conduct of those affairs has caused **prejudice to their interests as members** of the Company
4. That the prejudice suffered is **unfair**

# “Member”: Who may petition?

## Two Classes may petition (Section 994(2))



### Key Points:

- (1) Beneficial owners have no standing (*Re McCarty Surfacing* [2006] EWHC 832 (Ch))
- (2) Former members cannot petition (*Re a Company No. 00330 of 1991* [1991] BCLC 597)



# Minority Shareholders only?

- **Not strictly a requirement**

- 50/50 shareholders can petition
- Majority shareholder without control can petition (***Re Ravenhart Service (Holdings) Ltd*** [2004] 2 BCLC 376)

BUT

- No remedy available under s.994 where a majority member can avoid prejudice by exercise of majority rights (***Re Baltic Real Estate*** [1993] BCLC 503; ***Re Legal Costs Negotiators Ltd*** [1999] 2 BCLC 171)

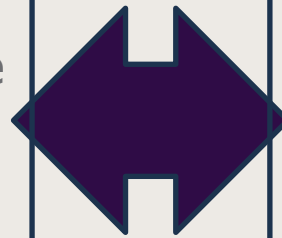
**Not But it is not a statutory prohibition: relief is available  
in exceptional circumstances  
Test if factual: Could the petitioner cure the unfairness?**

# Management of the affairs of the company?

## The words are wide and should be construed liberally

*"anything that the company does or fails to do can be relied upon"*  
(**Re Unisoft Group Ltd (No 3)** [1994] 1 BCLC 609 [611c])

- Acts of the board (and directors individually) are acts of the company
- Ordinary and special resolutions are acts of the company



- Acts of members (in that capacity are not acts of the company
- Breach of a shareholders' agreement by a shareholder not acts of the company (*Unisoft*)

**"Unfair prejudice proceedings are concerned to bring mismanagement to an end; derivative actions are concerned to provide a remedy for misconduct"**

# Management of the affairs of the company - Subsidiaries

**Parent - Subsidiary** (where parent has control) - parent's acts can be conduct of the affairs of the subsidiary ***Nicholas v Soundcraft Electronics*** [1993] BCLC 360 CA

**Subsidiary – Parent** (where common directors). - subsidiary's acts can be conduct of the affairs of the parent) ***Rackind v Gross*** [2005] 1 WLR 3505 (CA)

“conduct of the ‘affairs’ of a parent company includes refraining from procuring a subsidiary to do something or condoning by inaction an act of a subsidiary, particularly when the directors of the parent and the subsidiary are the same” (Re ***Dernacourt Investments Pty Ltd*** (1990) 2 ACSR 553)



# What is unfair prejudice?

**Unfairness and  
Prejudice Are  
Two Distinct  
Requirements**

**PREJUDICIAL**  
*Causes prejudice  
or harm to the  
relevant interest*

**UNFAIR**  
*Conduct must be  
unfair to petitioner*

**Conduct can be  
prejudicial  
but not unfair...**

See:

- *Jesner v Jarrod Properties*  
[1992] BCC  
807
- *Rock Nominees  
Ltd v RCO  
(Holdings) Ltd*

# Prejudice?

**Usually  
Economic**

A member will be able to establish prejudice when he can show that the economic value of his shareholding has been seriously diminished or put in jeopardy

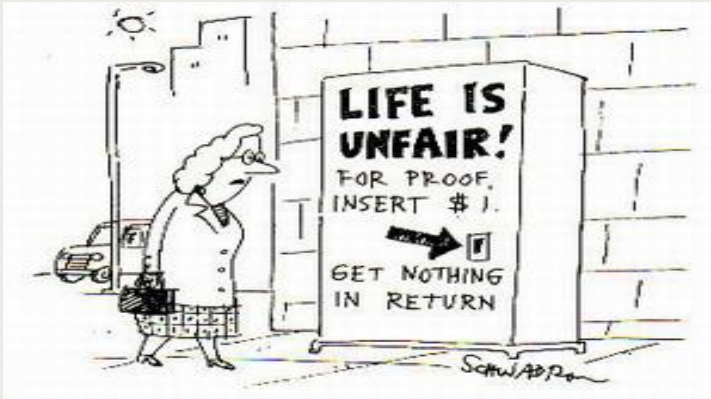
**(*Re Brenfield Squash Racquets Club Ltd* [1996] 2 BCLC 184).**

**But - Not always**

But this is not a necessity. Petitioners can succeed where, for example, they have been excluded from management, and there has been no prejudicial effect on the value of the shareholding

**Exclusion from management is a very  
common complaint in 994 petitions**

# Unfair?



## *O'Neill v Phillips* [1999] 1 WLR 1092

Only case to have reached the House of Lords on the question of how unfairness can be established for the purposes of s.994

### Unfairness can be established where:

1. There has been a breach of the terms on which it has been agreed that the affairs of the company should be conducted (eg a breach of the articles or a shareholders' agreement). (**'The basic rule'**)
2. Equitable considerations arising at the time of the commencement of the relationship which make it unfair for those controlling the company to rely on their strict legal powers under the company's constitution (**'the equitable rule'**)



# Unfair – an objective test...

## The test for unfairness is objective not subjective:

- The test is objective: "*the test, I think is whether a reasonable bystander observing the consequences of their conduct would regard it as having unfairly prejudiced the petitioner's interests*" (**Re Bovey Hotel Ventures Ltd** – cited in **RA Noble & Sons Clothing Ltd** [1983] BCLC 273 [290])
- The concept of fairness must be applied judicially and the context which is given by the courts must be based on rational principles (**O'Neill v. Phillips** [1098 D-E])
- Good summary of relevant principles in Court of Appeal judgment in **Grace v Biagioli** [2006] 2 BCLC 567

"Unfairness may consist in a breach of the rules or using the rules in a manner which equity would regard as contrary to good faith"  
**(O'Neill v Phillips [1099])**

# Unfairness – CA Guidance

**In *Grace v Biagioli*, Patten J identified five principles [61]:**

1. Unfairness **is objective** but need not be considered in a vacuum: need to consider context including corporate structure, articles and collateral agreements – subject to equitable principles
2. Not usually unfair to conduct the affairs of the company **in accordance with its articles and other legally enforceable agreements** (subject to equitable principles on good faith)
3. Equitable principles to be applied in accordance with **established equitable principles**: not by reference to notion of fairness
4. To be unfair, **need not justify a winding-up on just and equitable grounds** as formerly required under s210 CA 1948
5. Useful test: would exercise of right amount to a breach of an agreement of understanding that it would be unfair to allow a member to ignore: such agreements/understandings **do not need to be contractually binding** in order to found the equity

# Examples of Unfairness

## Common example of unfairness:

- Exclusion from management / removal as a director
- Breaches of directors' fiduciary duties
- Failure to consult the petitioner or provide information
- Misappropriation of assets by directors / excessive remuneration
- Failure to comply with company law / articles of association
- Failure to consider, declare, or pay dividends
- Illegality and failure to comply with the CA 2006.



## What is required to justify the imposition of equitable considerations – quasi partnership:

- The starting point is Lord Wilberforce in, ***Ebrahimi v Westbourne Galleries*** [1973] AC 360:
  - An association formed on or continued on the basis of **personal relationships** involving **mutual confidence**
  - An agreement that all (or some) of the shareholders shall **participate in the conduct of the business**
  - **Restrictions on the transfer of shares** so that in the event of a member being removed from office, they cannot take out their stake and go elsewhere

A company exhibiting some or all of the above features may be a quasi-partnership: but:  
(1) term is only shorthand for the type of company that attracts equitable considerations; and (2) Lord Wilberforce's list is non-exclusive

# Section 996: Relief available...

Lots of authority that s.996 is exceptionally broad and the court has discretion to make such orders as it thinks fit

**Section 996(2)** sets out some specific orders which the court may make:

- Require the company to do or not do something (eg disposal of an asset)
- Preventing the company from altering its articles without leave of the court.
- Authorising proceedings in the name of the company (ie a Derivative Claim).
- Providing for the purchase of shares by other members or the company itself.

**Most common order is for the majority to buy out the minority at a share price determined by an expert.**

# Section 996: Valuation

## Valuation of minority shareholding:

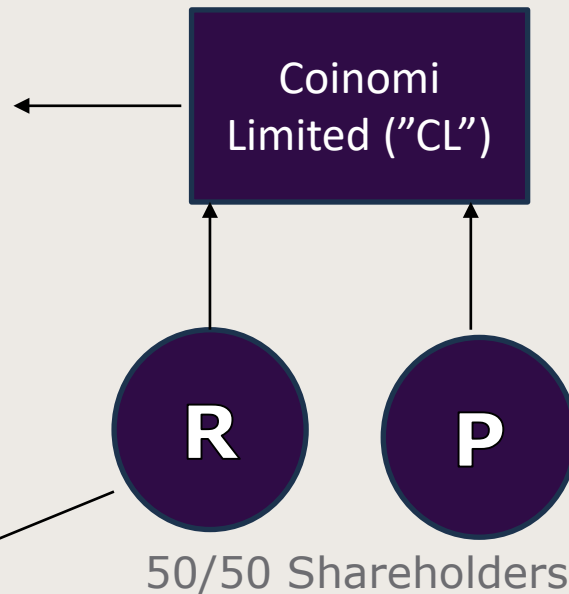
- Generally, no minority discount (***Re Bird Precision Bellows*** [1984] Ch 419 (at 413f) – but not always the case (see ***O’Neill v. Phillips*** [1999] 2 BCLC 1)
- Date of valuation: generally, the date of the order for sale (***Re London School of Economics*** [1986] Ch 211 (at 224))
- Method of valuation:
  - EBITDA multiples
  - Asset based valuation (e.g. property companies)
  - DCF (financial modelling, complex but accurate)
- Adjustments to valuation (but for prejudicial conduct)

**Usually a good idea to involve a valuation expert at an early stage**

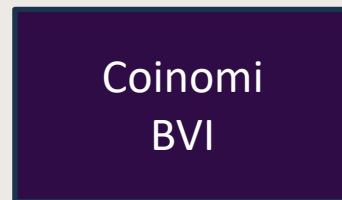
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# Ntzegkoutanis v. Kimionis (Coinomi)



Subsidiary



- Incorporated by R – Oct 2018
- Company applied to register TM in USA
- Transferred 'Coinomi' domain name
- Transferred source code

- Cyprus licensed BVI to use the source code

## • P's claim:

- Cyprus/BVI liable to CL as knowing recipients and assets held on constructive trust; and/or
- Cyprus/BVI knowingly assisted R in breaches of FD

## • Relief claimed (*inter alia*):

- Order for R to sell shares to P
- Order for compensation to CL in respect of CL's losses
- Declaration that assets held by Cyprus/BVI on trust for CL



Primary Q: can the court grant relief for losses suffered by the company under section 994/996

## ISSUE

- “Proper plaintiff rule” (***Foss v Harbottle*** (1843) 67 ER 189): in any action in which a wrong is alleged to have been done to a company, the proper claimant is the company
- Does allowing claims in relation to losses made by the company under s.994/996 subvert that rule?
- Did P require the permission of the court under 260 CA 2006?

*The case is an example of a classic unfair prejudice claim where P relied on: (1) exclusion from management; and (2) misappropriation of the assets of the company*

## First instance judge defined the “question of principle” as:

*“...whether the petitioner ought to be permitted to proceed to trial on the petition in respect of matters which could have been litigated against [the Respondents] by way of a derivative claim which [R] argued, by being pursued by way of an unfair prejudice petition, outflanked the limitations in [the 2006 Act] on making derivative claims”*

## The Judge’s approach:

- Judge adopted the approach in ***Re Chime Corp Ltd*** (2004) 7 HKCFAR 546 – claims that could be derivative claims can proceed as unfair prejudice in “*rare and exceptional*” cases
- Test – can the claim be “*conveniently adjudicated*” within the unfair prejudice proceedings
- Decided they could not – struck out compensation claim and constructive trust claim

# Coinomi – Court of Appeal

## The judgment of Newey LJ:

1. The claim **was** a claim in respect of a cause of action vested in the company (s.260(1)(a))
2. P was **not** seeking relief on behalf of the company (s.260(1)(b)): the claims were brought for P's own benefit
3. Snowden LJ concluded that it was not a claim in respect of a cause of action vested in the company – Chapter 11: intention was that it should replace the common law derivative action: nothing to suggest that it was intended to oust any application of s.994 and Law Commission expressly stated that the claimant should have the right to choose between the two

If the relief sought independently under s.994 (Newey LJ [38]); how can it be said to be in respect of a "*cause of action vested in the company*"? (see Snowden LJ [64] and [74])

# Coinomi – Court of Appeal

## Conclusions on the legal principles:

### Newey LJ set out six points of legal principle [55]:

1. The court has established jurisdiction to grant relief in favour of the company in a 994 petition
2. Generally, in 994 proceedings, the court should not grant such relief unless the company would have been entitled to that relief independently
3. A petition claiming only relief for the company is likely to be an abuse of process
4. Where petition is for relief in favour of the company **and** relief under 994 that would not be available Part 11 claim - not appropriate to strike-out any part
5. Issues need to be considered as part of case management – split trial
6. Chime does not represent the law of England & Wales: use of 994 is not restricted to “*rare and exceptional cases*”

“It is not difficult to conceive of a situation in which it would make sense for a petitioner to include in an unfair prejudice petition a claim for, say, an order for a respondent to buy or sell shares and an order for a payment to be made to the company on the basis of a breach of duty by a respondent”

# Coinomi – Points to consider

## Judgment is not particularly surprising, but:

1. Mainly applicable where R seeks to buy the shares and operate the company: in a 'classic' majority buy-out, the loss can be compensated by the method of valuation (and usually is)
2. If: (1) court has jurisdiction under 994 to grant such relief; and (2) the claim is made only under a 994 petition in the name of a member: how can it be said that the claim is *"in respect of a cause of action vested in the company"*?
3. If it is accepted that P was not seeking relief on behalf of the company because he is "exercising his personal entitlement as a member of the company" (Newey LJ [38]): how can it be said that that relief is in respect of a cause of action vested in the company (the point made by Snowden LJ [74])
4. Consider traditional distinction made by Lord Millett in *Waddington Ltd v Thomas* [2009] BCLC 82 between claims for: (1) mismanagement: unfair prejudice; and (2) claims for a remedy for misconduct: derivative claims.

**Is the only question is whether the claim is brought in a representative capacity? (Snowden LJ [74])**



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