Coming of age?

Daniel Lightman revisits the statutory derivative claim…three years on

IN BRIEF

- The approach which the courts have taken to the statutory derivative claim in its first three years, including the two-stage application for permission and costs indemnity orders.

The statutory derivative claim recently celebrated its third birthday. It was created by Part 11 of the Companies Act 2006 (CA 2006), which came into force on 1 October 2007.

This article first considers the approach which the courts have taken to the statutory derivative claim in its first three years, and then identifies two potentially significant issues as to the ambit of derivative claims which are currently unclear and await resolution by the courts, namely whether the common law derivative claim has been abolished and whether such claims can be brought in respect of a company in liquidation.

The two-stage application for permission

Because he is seeking to bring a claim not on his own behalf but on behalf of and for the benefit of the company of which he is a member, after issuing the claim and served an application for permission, to which the defendants to the claim have been made respondents, thereby by-passing the first stage entirely. In such cases, in order to avoid unnecessary delay and cost defendants have frequently, eg *Franbar Holdings Ltd v Patel* [2009] 1 BCLC 1 and *Mission Capital Plc v Sinclair* [2010] 1 BCLC 304, agreed to treat the hearing as the second stage of the permission application. Indeed, in *Stimpson v Southern Landlords Association* [2010] BCC 387, the court overrode the defendants' objection to telescoping the two-stage procedure into one.

The first stage

At the first stage, if satisfied that the application and the evidence filed by the claimant in support of it do not disclose a prima facie case for giving permission, the court must dismiss the application for permission and make any consequential order it considers appropriate.

> **"Nor is it still possible to bring a derivative claim in respect of an overseas company"**

form the derivative claimant must apply for permission to continue the claim. CA 2006 provides for a two-stage procedure for the court to consider the permission application. The first stage was not recommended by the Law Commission, but was added to CA 2006 at a late stage in the House of Lords, with a view to enabling the court to make a speedy decision to dismiss the claim.

While the prescribed two-stage procedure has been followed in some cases, eg *Iesini v Westrip Holdings Ltd* [2010] BCC 420, on several occasions it has not. A number of derivative claimants have simply issued

In *Wishart v Castlecroft Securities Ltd* [2010] BCC 161 the Scottish Court of Session (Inner House) appeared to place a low threshold for a claimant at this juncture. It pointed out that the question is not whether the application and supporting evidence disclose a prima facie case *against the defendants*, but whether there is no prima facie case disclosed *for granting the application for permission*, and stated that no onus is placed on the claimant to satisfy the court that there is a prima facie case: rather, the court is to refuse the application if it is satisfied that there is not a prima facie case. In contrast, in *Iesini v Westrip Holdings Ltd*, Lewison J took a stricter approach, expressing the view that a prima facie case for giving permission "necessarily entails a decision that there is a prima facie case both that the company has a good cause of action and that the cause of action arises out of a directors' default, breach of duty (etc)".

The second stage

To date there have been only two reported English cases in which derivative claimants have successfully overcome the second stage of the permission application. In both cases (*Kiani v Cooper* [2010] BCC 463 and *Stainer v Lee* [2010] EWHC 1539 (Ch)) the court declined to exercise its power to grant permission to proceed with the claim to trial, but instead only granted limited permission until after disclosure, at which stage the claimant, if so advised, must apply for further permission.

The reason for adopting this course was, as Roth J explained in *Stainer v Lee*, that after disclosure the facts and strength of the case would be much clearer: "Where a Company has what appears to be a very strong case of breach of duty but it is unclear whether all the resulting loss has now been repaid it is in my judgment appropriate for that case to proceed at least as far as disclosure so that a more accurate view can be reached as to the quantum of loss."

In a number of cases permission has simply been refused, most recently in *Cinematic Finance Ltd v Ryder* (LTL 21/10/2010), where Roth J held that while it could not be said that it would never be appropriate for a derivative claim to be brought by a majority shareholder in control of a company, permission to do so would be given only in very exceptional circumstances, and it was difficult to envisage what such exceptional circumstances might be.

In two cases the court has exercised

its power under CA 2006, s 261(4)(c) to adjourn the permission application, without either granting or refusing permission to continue the derivative claim. In *Iesini v Westrip Holdings Ltd* Lewison J, instead of granting permission to continue one aspect of the derivative claim, directed the company's board to reconsider its defence to a claim which had been brought against it. In *Fanmailuk.com Ltd v Cooper* [2008] BCC 877, as a matter of case management a trial of the claimant's personal claim was directed by way of preliminary issue in the action and the permission application adjourned until after the conclusion of that preliminary issue.

Companies in liquidation

- Another live issue is whether a derivative claim can be brought in respect of a company which is in liquidation. Pre-CA 2006 it was held that a common law derivative claim could not. There is no specific indication in CA 2006 as to whether a derivative claim can be brought under the Act where the company is in liquidation. Some Australian courts have, following the creation of a statutory derivative claim by the Australian Corporations Act 2001, indicated or found that members should be entitled to apply for leave to institute derivative proceedings where the company is in liquidation.
- Since the statutory derivative claim under CA 2006 represents a new dispensation, it is possible that when faced with applications for permission to bring derivative claims under CA 2006 in respect of a company in liquidation the British courts will adopt a different position to that which existed at common law.

Costs indemnity orders

In *CCUIST v C.U.F.C. Holdings Ltd* [2010] EWCA Civ 463, where the derivative claim had been settled (save for costs) before the determination of the application for permission to continue it, Arden LJ spoke of the derivative claimant having "an expectation of receiving its proper costs from the Companies on an indemnity basis if the action had gone forward: *Wallersteiner v Moir* (No 2) [1975] QB 373".

However, in the two cases where costs indemnity orders have been made in ongoing derivative claims, the courts were acutely conscious of the danger of imposing a potentially significant (and potentially uncapped and disproportionate) financial obligation on the company. In *Stainer v Lee*, Roth J noted that where the amount of likely recovery is presently uncertain, there is concern that the claimant's costs could become disproportionate. He accordingly placed a ceiling on the costs for which he granted an indemnity for the future (excluding the costs of the permission application) at £40,000, but gave the claimant liberty to apply to extend the scope of that indemnity. An even more limited costs indemnity order was made by Proudman J in *Kiani v Cooper*, where she stated that where, as in that case, the dispute is one between the two directors and shareholders, the court ought to take a realistic view, adding: "There are no significant unsecured creditors of which Mrs Kiani is aware whose interests come into the equation. There is some analogy with the trustee beneficiary who brings a *Beddoe* summons for directions to sue his fellow trustee beneficiary and asks for his costs of doing so out of the fund. In such circumstances the court is likely to refuse to force the defendant to fund proceedings against him. The claimant must take the risk as to costs. On that basis I am prepared to make an order that Mrs Kiani's costs should be borne by the company, but I am not prepared to grant her an indemnity in respect of any adverse costs order... It seems to me that she should be required to assume part of the risk of the litigation. However, that part of the order will be subject to review after disclosure."

The ambit of derivative claims

A lack of clarity in the drafting of the statutory derivative claim has led to some interesting issues concerning the scope of derivative claims post-CA 2006, which await resolution by the court. One is whether as a result of the coming into force of CA 2006 it is no longer possible to bring multiple derivative claims or derivative claims in respect of overseas companies. The Law Commission firmly recommended that the statutory derivative claim procedure should replace the common law derivative action entirely. The question arises whether its recommendations have been implemented.

If they have, then it is not now possible (to the extent that it was previously possible at common law) to bring a multiple derivative claim—a claim by a shareholder in a parent company on behalf of a subsidiary whose shares are held by the parent company (a "double derivative claim") or a claim by a shareholder in the parent company on behalf of subsidiaries of the subsidiary (a "triple derivative claim"). The significance of whether multiple derivative claims survive is that, as Lord Millett has recently pointed out, it is frequently the case that groups of companies trade through wholly-owned subsidiaries, and accordingly the assets at risk of misappropriation are more likely to be situate in the trading subsidiaries than in the holding company. Nor, on the same hypothesis, is it still possible to bring a derivative claim in respect of an overseas company. This is because the word "company" is defined by CA 2006, s 1 for the purposes of that Act so as to exclude overseas companies.

However, there is a respectable argument that CA 2006, s 260(2) does not have the effect of abolishing any derivative claims which do not fall within the definition of "derivative claim" in s 260(1), but simply prescribes the procedure to be followed in respect of any claim which falls within the s 260(1) definition of "derivative claim". In that case, it does not abolish the common law derivative claim, which survives in respect of overseas companies and multiple derivative claims. NLJ

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