Equality of arms

Daniel Lightman on minority shareholders, disclosure and s 459 petitions

- the right to equality of arms
- *Arrow v Edwardian Group Ltd*—how to secure advance disclosure

The scenario is a common one. The minority shareholder (P) is unhappy at how the managing director is running the company. The MD, who together with his family controls the majority of the company's shares, engineers the dissentient shareholder's removal from the board, thereby drastically limiting his access to information about the management of the company.

"Arrow v Edwardian Group Ltd has highlighted how a petitioner can obtain full and early disclosure from the company, and require all respondents to comply with their disclosure obligations"

P presents a petition under s 459 of the Companies Act 1985. He is aware of potentially unfairly prejudicial conduct by the MD and suspects that this is merely the tip of the iceberg. How can he make good his case? How can he prevent the MD limiting his access to documents in the possession of the company or the other shareholders? And how, without having to incur the bulk of the up-front costs of a full trial (or perhaps two separate trials) on liability and quantum, can he find out how much his shares are worth?

Arrow v Edwardian Group Ltd [2004] EWHC 1319 (Ch) has highlighted how a petitioner in a position like P can obtain full and early disclosure from the company, and require all respondents personally to comply with their disclosure obligations (rather than delegate that duty to the MD).

Right to equality of arms

The starting point is P's right to a fair trial bestowed by Art 6(1) of the European Convention on Human Rights. This is because one of the rights the European Court of Human Rights has found to inhere in Article 6(1) is the right to equality of arms, which requires each party to be afforded a reasonable opportunity to present his or her case under conditions that do not place him or her at a substantial disadvantage vis-à-vis their opponent: see *De Haes and Gijsels v Belgium* (1998) 25 EHRR 1. (This principle is echoed in the principle of ensuring that the parties are on an equal footing at CPR Part 1.1(2)(a)).

Where a non-director shareholder sues a fellow shareholder who is also a director of the relevant company, the right to equality of arms demands that if potentially material company documents are available to the defendant director, they should also be available to the non-director shareholder. The situation is particularly striking in the scenario posited above, as the MD engineered P's removal from the board.

The need to ensure equality of arms can lead to disclosure even being ordered of relevant company documents to which legal professional privilege attaches, provided that they do not relate to hostile litigation between P and the company. (The situation is the same where the company is a nominal party in litigation between shareholders, and regardless of the size of the company.)

Advance disclosure

Equality of arms can also be prayed in aid to allow P to obtain advance disclosure of documents enabling him to value his shareholding. It cannot be right that the MD is in a position to make a CPR Part 36 payment at the outset of proceedings but P is not in a position properly to value the company (and hence his shareholding in it) and so to make an offer compliant with the requirements of CPR Part 36.5 (and obtain the potential advantages that flow from it) until after disclosure (or, where a split liability/quantum trial has been ordered, after disclosure prior to the second, quantum, trial).

Unless remedied, P's inability to make a properly informed Part 36 offer is a significant detriment to him. This is because were he to make a CPR Part 36.5-compliant offer that is not accepted by the shareholder respondents and at trial they are held liable for more, or the judgment is more advantageous to P than that offer, then the court may order them:

(i) to pay interest from the latest date when the offer could have been accepted without needing the permission of the court, at a significantly enhanced rate on any sum of money awarded to P;
(ii) to pay P's costs on the indemnity basis from the latest date when he could have accepted the offer without permission of the court; and
(iii) to pay P interest on costs at a similarly enhanced rate.

These advantages are not available when P makes an offer otherwise than in compliance with CPR Part 36.5. If P seeks a share-purchase order in a company of any substance, the amount of additional interest potentially awardable to him is not insubstantial.

In order to achieve equality in procedure the court can (and on occasion should) require a party to provide his opponent with early information to enable the latter to make a realistic Part 36 offer to settle (or to respond to such an offer): see *Gnitrow Ltd v Cape plc* [2000] 1 WLR 2327 (CA).

A further reason for advance disclosure so as to enable P to value his shares is to enable a mediation to take place at any stage of proceedings without his being at a disadvantage. This is in accordance with the court's duties pursuant to CPR Part 1.4(2), when furthering the overriding objective by actively managing cases, of:

"(e) encouraging the parties to use an alternative dispute resolution procedure if the court considers that appropriate and facilitating the use of such procedure; [and]
(f) helping the parties to settle the whole or part of their case".

In relation to many s 459 petitions, a central issue a facilitated settlement needs to address is the purchase by the respondent shareholder(s) (or the company) of the petitioner's shares. Accordingly, it would often be appropriate for the petitioner to seek advance disclosure from the company of financial documents, on the basis of which he can (with the benefit of relevant professional advice) come to an informed view as to the value of the company and his shares in it.

Arrow v Edwardian Group Ltd

A recent example of petitioners successfully deploying the above arguments to obtain extensive advance disclosure from the company is *Arrow v Edwardian Group Ltd* [2004] EWHC 1319 (Ch). In that case, since split liability/quantum trials had been ordered, the petitioners would not normally have been entitled at

that stage to disclosure from the company of documents relevant only to quantum issues. However, Blackburne J ordered advance disclosure from the company of documents needed by the petitioners to value their shares. He did so, at least in part, "to enable the petitioners to make a realistic Part 36 offer or engage in meaningful mediation".

Blackburne J also ordered the company to disclose to the petitioners documents that ordinarily would be immune from disclosure on the ground of legal professional privilege. The background was as follows. Fearing that the company was spending or planning to spend its resources in furtherance of its wish to participate actively in the petition, and believing that such participation and therefore such expenditure would be wrongful, the petitioners had applied for an order restraining the company from doing so.

The company opposed the petitioners' application, but following a contested hearing Sir Francis Ferris ([2003] EWHC 2863 (Ch)) granted the petitioners a permanent injunction restraining the company from expending its moneys and actively participating in the petition in the manner in which it had indicated its wish to do.

The petitioners thereupon amended their petition to add an allegation that in causing the company to seek to participate actively in the proceedings and to expend its monies on a dispute between its shareholders, the directors of the company were guilty of misfeasance and had caused the company to act in a manner unfairly prejudicial to the petitioners' interests. This allegation was denied by the respondent shareholders.

The petitioners then applied for specific disclosure from the company of any documents evidencing the company instructing and seeking advice from solicitors and counsel about how it should respond to the petition, the advice that it received and any documents recording what, if any, deliberations there were before and after obtaining advice that bore upon those matters.

Blackburne J rejected the company's assertion of legal professional privilege, stating: "It is well established by authority that a shareholder in the company is entitled to disclosure of all documents obtained by the company in the course of the company's administration, including advice by solicitors to the company about its affairs, but not where the advice relates to hostile proceedings between the company and its shareholders: see *Re Hydrosan Ltd* [1991] BCLC 418, [1991] BCC 19 and *CAS (Nominees) Ltd and others v Nottingham Forest plc and others* [2001] 1 All ER 954. The essential distinction is between advice to the company in connection with the administration of its affairs on behalf of all of its shareholders, and advice to the company in defence of an action, actual, threatened or in contemplation, by a shareholder against the company."

In the instant case, the company was a nominal defendant, and had no independent position in relation to the issues between the petitioners and the shareholder respondents. The advice sought and obtained was in connection with what, if any, action the company should take in response to the petition in the interests of all of its shareholders.

In the circumstances, Blackburne J saw "no basis on which the company can assert any entitlement to privilege in connection with these matters," and so the shareholders' ordinary right to disclosure applied.

Disclosure statements

Unless the parties otherwise agree in writing, the disclosing party's list of documents must include a disclosure statement. If the disclosing party is an individual, the disclosure statement must be signed by the party himself or herself, and not (for example) their legal representative: CPR Part 31.10(6). The only exception is that where an insurer, or the Motor Insurers' Bureau, has a financial interest in the outcome of the proceedings, it may sign a disclosure statement on behalf of a party: CPR Part 31.10(9) and PD 31, para 4.7.

The duty on the part of a particular person to sign a disclosure statement cannot be delegated: see *Carlco Ltd v Chief Constable of Dyfed-Powys Police* [2002] EWCA Civ 1754, LTL 18/11/2002.

By CPR Part 31.10(6), a disclosure statement must:

(a) set out the extent of the search that has been made to locate documents which are required to be disclosed;
(b) certify that the signatory understands the duty to disclose documents; and
(c) certify that to the best of his or her knowledge he or she has carried out that duty.

In *Arrow*, a single composite list of documents was filed on behalf of all ten of the respondent shareholders, with a single disclosure statement signed by the MD. The petitioners sought an order that each of the respondents file their own list of documents, and personally sign the requisite disclosure statement.

Blackburne J held that the single disclosure statement did not comply with the requirements of the rule, because (i) none of the parties giving disclosure (other than the MD) had deposed that he or she was aware of and understood the duty of disclosure; (ii) none of them (other than the MD) appeared personally to have carried out that duty; (iii) it was not clear what, if any, search any of the respondent shareholders had made to locate the documents to be disclosed; and (iv) it was not clear which documents had been (and had not been) disclosed by each of the respondent shareholders.

> *"The purpose of the rule is to bring home to each party his or her individual responsibility for giving standard disclosure"*

Blackburne J rejected the submission that the non-compliance was a mere technicality, stating: "The purpose of the rule is to bring home to each party his or her individual responsibility for giving standard disclosure. Except to the extent permitted by the rules, it requires the party himself to make the disclosure statement. This clearly has not happened."

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Practical points on disclosure

- Where a minority shareholder has presented a s 459 petition, by exercising the right to equality of arms he can obtain disclosure from the company of documents to which the majority shareholders have access.
- The classes of document which the company can be ordered to disclose include:
  - documents to which legal professional privilege applies, if they do not relate to hostile litigation between the petitioner and the company; and
  - documents needed by the petitioner in order to enable him to value his shareholding and so make an early Part 36 offer or engage in meaningful mediation.
- All respondents to a s 459 petition must provide their own disclosure statement personally signed by that party.