



23 May 2007

Companies Act 2006 – Derivative Claims

Dear Sirs

The Companies Act 2006 (“the Act”), which received Royal Assent on 8 November 2006, has, amongst other things, made changes to the substantive law on derivative claims. This letter invites your views about proposed rules of court to support the changes contained in the Act.

In England and Wales, it is already possible as a matter of common law for a member of a company to bring an action, in certain circumstances, on behalf of the company—this is termed a derivative claim. A member may bring such an action to enforce liability for a breach by one of the directors of his duties to the company. The Civil Procedure Rules 1998 (“the Rules”) currently provide for derivative claims in Part 19, rule 19.9. That rule also covers derivative claims against an incorporated body that is not a company, or against a trade union. A trade union, although not incorporated in the full sense, has quasi-corporate status under section 10 of the Trade Union and Labour Relations (Consolidation) Act 1992, and can sue and be sued in its corporate name.

Copies of draft new rules and a draft Practice Direction supplementing the new rules are attached.

The draft rules must be read in conjunction with sections 260 to 264 of the Act. You may recall that those sections were exhaustively debated in both Houses of the Parliament, and the Rules give procedural effect to those sections.

The Act requires a person seeking to bring a derivative claim to obtain the permission of the court to do so. Both the existing and proposed rules basically apply to the application for that permission—if permission is granted the claim proceeds in the same way as any other claim. The Act provides in section 261(2) for the court to dismiss an application “on the papers” alone without the company being required to file

any evidence, and the draft new rules make appropriate provision. The new rules provide for that decision to be reconsidered at an oral hearing if the claimant so requests. Until the court has decided, on the evidence filed by the claimant, whether or not there is a prima facie case, the company is not required to be involved in any way, although it must be notified (except if the court orders otherwise, in exceptional circumstances). However, if the court is unable to dismiss the application on the basis that the claimant's evidence discloses no prima facie case, the court will hold a hearing at which the defendant company can make representations. If the court grants permission to continue the claim, it may do so on terms, and can make appropriate consequential orders. Of course the court also has all the case management powers already available under the Rules.

It is intended that permission applications, if brought in the High Court, will be assigned to the Chancery Division in common with all other company matters. If brought in a county court, a permission application would be heard by a circuit judge.

The requirement for permission also applies if a claim that a company has already brought is to be taken over by a member and continued as a derivative claim, or if an existing derivative claim is to be taken over by another member of the company concerned.

As mentioned above, the present rules also apply to derivative claims against incorporated bodies of other kinds. It is proposed that the procedural aspects of the new Act provisions should apply to such derivative claims. This is proposed to be effected by a specific rule for such claims that simply incorporates by reference the relevant Act provisions and the relevant provisions of the rules that apply to companies. It should be noted that derivative claims against bodies other than companies are extremely rare.

A provision of the draft practice direction states that if the court grants permission to continue a derivative claim, it may impose a condition that the claim is not to be settled, discontinued or compromised without the permission of the court. This is intended to discourage the development in England and Wales of so-called "greenmail" claims, where a person buys shares in a company and brings a claim which is settled on terms that include a purchase of the claimant's shares at a price above their market value.

Because the sections of the Act that deal with derivative claims comes into effect in October 2007, because the relevant sections of the Act have already been extensively debated in Parliament, and because the rules are procedural only and create no substantive rights, the Rule Committee decided that the four-week period for consultation allowed by the need to make the rules before the Act provisions come into force was sufficient.

This consultation is being carried out by Her Majesty's Court Service, a division of the Ministry of Justice, on behalf of the Civil Procedure Rule Committee, a non-Departmental public body. The Committee has a statutory duty to 'consult such persons as they consider appropriate' when making rules of court (Civil Procedure Act 1997, s. 2(6)(a)). You are invited to comment on the draft.

In particular comments are sought on the following two questions.

1. A company is not required to respond to a member's application for permission to continue a claim. However, it is considered important that the company is made aware that a claim is being made, even though it need take no action unless permission is granted. It is proposed that an application to continue a claim should be notified to the company which would, at the same time, receive a copy of the claim form and the application to for permission. A notification will be used rather than the application and claim form being formally served on the company. The current draft makes provision for such a notification.

Do you consider—

a. A notification is necessary? If not please explain why not.

b. Should the claim form and application be served rather than notified?

2. Where a company reaches a settlement with a claimant in a derivative claim and the claimant discontinues the case, claims on the same grounds by other shareholders could be precluded. The settlement will require the court's approval. To safeguard other shareholders the draft proposes to enable the court, where it is considered appropriate, to grant permission to continue the claim subject to conditions, in particular a condition that the claim not be settled or compromised without the court's permission. Permission to compromise or settle could be granted on terms, perhaps including a term that other shareholders be informed of the settlement.

Do you agree that the court should be able to approve the settlement of a derivative claim subject to conditions in appropriate cases? If not why not?

May we please have your views by 5th July. Because of the shortage of time to make the rules before the relevant provisions of the Act come into force, there can be no extension to this deadline.

Comments should be sent to:

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Yours faithfully

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