

Derivative Claims Metadata

Empirical analysis of the statutory derivative claim: De facto application and the sine quibus non

DATA TITLE AND DESCRIPTION

Data File Name: D. Gibbs and C. Ogbonnaya (2018) *Derivative Claims Quantitative Analysis 1874-2017*. [Data Collection]. Colchester, Essex: UK Data Archive.

Data description:

The data looks to explore how the statutory derivative claim procedure is being applied de facto when compared with the equitable procedure. We investigate whether the procedure is more accessible to shareholders to increase their incentives to litigate. We do this through inference by analysing whether more claims establish a prima facie case, less time is spent in court, and whether more claims are successful. We also use the data to consider the effect the statutory procedure has on approximating the 'efficient contract' between shareholders and directors in achieving the corporate purpose of maximising the wealth of the company. If more claims are successful this may only tell us how the incentives are biased between the actors. To infer from the data conclusions about the corporate purpose we analyse the change between the two procedures concerning the quality and type of claims that have been brought.

DATA INFORMATION

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Project Title: Quantitative Skills Acquisition with the Eastern Academic Research Consortium

Project Description: The proposed project is designed to enhance my quantitative skills with a view to have a core impact on the strength of legal research and training in line with the British Academy and Economic and Social Research Council's strategy. Therefore the project is aimed at enhancing my knowledge of advanced quantitative research techniques, to offer empirically based policy suggestions in legal studies and consequently use the knowledge acquired to mentor law students in quantitative research methods. The proposed project will be undertaken with the University of East Anglia's (UEA) Eastern Academic Research Consortium (EARC). The EARC is a research partnership between the Universities of Kent, Essex and UEA. One of the EARC's main areas is quantitative social science. My mentor, Dr Chidiebere Ogbonnaya, is the EARC post-doctoral fellow, a specialist in quantitative methods and is based at UEA where the project will take place. Given the

collaborative nature of the EARC, I will benefit from the networks and training from each institution.

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AVAILABLE FILES

All Documentation and ReadMe files were originally created in .docx formatted. They were subsequently converted to .pdf format.

Data

Derivative_Claims_Quantitative_Analysis_1874-2017_v0 3.sav

Documentation

Derivative_Claims_Quantitative_Analysis_1874-2017_Metadata.pdf

Hypotheses_Methodology_and_Results_v0 1.pdf

Derivative_Claims_Working_Paper_v0 4.pdf

Read Me

ReadMe.pdf

VARIABLE INFORMATION

Variable 1 – Case_Name

Label: Case Name

This is the name of each derivative claim that forms the sample. All claims heard under the new procedure were selected. A sample of those heard under the equitable procedure were then selected.

There was no distinct procedure for bringing a derivative action until 1982 when the Civil Procedure Rules were introduced. Cases selected in the sample before then concerned cases looking to bring themselves within one of the exceptions to the rule in *Foss v Harbottle*.

The full citations are as follows:

Bamford v Harvey [2012] EWHC 2858 (Ch); [2013] Bus. L.R. 589

Brannigan v Style [2016] EWHC 512 (Ch)

Bridge v Daley [2015] EWHC 2121 (Ch)

Cinematic Finance Ltd v Ryder [2010] EWHC 3387 (Ch)

Cullen Investments Ltd v Brown [2015] EWHC 473 (Ch);

Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Ch); [2008] B.C.C. 885

Hook v Sumner [2015] EWHC 3820 (Ch)

Hughes v Weiss [2012] EWHC 2363 (Ch)

Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch); [2010] B.C.C. 420

Kleanthous v Paphitis [2011] EWHC 2287 (Ch); (2011) 108(36) L.S.G. 19

Kiani v Cooper [2010] EWHC 577 (Ch); [2010] B.C.C. 463

McAskill v Fulton [2014] unreported (DR (Newcastle));

Mission Capital Plc v Sinclair [2008] EWHC 1339 (Ch); [2008] B.C.C. 866

Parry v Bartlett [2011] EWHC 3146 (Ch)

Phillips v Fryer [2012] EWHC 1611 (Ch); [2013] B.C.C. 176

Re Seven Holdings Ltd [2011] EWHC 1893 (Ch);

Re Singh Brothers Contractors (Northwest) Ltd [2013] EWHC 2138; [2014] EWCA

Civ 103

Stainer v Lee [2010] EWHC 1539 (Ch); [2011] B.C.C. 134

Stimpson v Southern Landlords Association [2009] EWHC 2072 (Ch); [2010] B.C.C.

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Zavahir v Shankleman [2016] EWHC 2772 (Ch); [2017] B.C.C. 500 (Ch D)
SRI Retail Services Ltd v King [2017] EWHC 737 (Ch) (CHD)
Edwards v Halliwell [1950] 2 All ER 1064
Daniels v Daniels [1978] Ch 406
Estamnco v Greater London Council [1982] 1 All ER 437
Pavrides v Jensen [1956] Ch 565
Airey v Cordell [2006] EWHC 2728 (Ch); [2007] BCC 785
Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204
Smith v Croft (No 2) [1988] Ch 114
Wallersteiner v Moir (No 2) [1975] QB 373
Barrett v Duckett [1995] 1 BCLC 243
Cook v Deeks [1916] 1 AC 554
Burland v Earle [1902] AC 83
Jaybird Group Ltd v Greenwood [1986] BCLC 319
Russell v Wakefield Waterworks Co (1875) LR 20 Eq 474
Menier v Hooper's Telegraph Works (1874) 9 Ch App 350
Nurcombe v Nurcombe [1985] 1 WLR 370
Turquand v Marshall (1869) LR 4 Ch App 376
Towers v African Tug Co [1904] 1 Ch 558
Konamaneni v Rolls Royce [2002] 1 WLR 1269
Mumbray v Lapper [2005] EWHC 1152
Halle v Trax BW Ltd [2000] BCC 1020
Fargro Ltd v Godfroy [1986] 1 WLR 1134
Harley Street Capital Ltd v Tchigirinsky (No.2) [2005] EWHC 1897 (Ch)
Jafari-Fini v Skillglass Ltd [2005] EWCA 356; appellate history [2004] EWHC 3353
Reeves v Sprecher [2007] EWHC 117 (Ch)
Portfolios of Distinction Ltd v Laird [2004] EWHC 2071
Bhullar v Bhullar [2015] EWHC 1943
Re Fort Gilkicker Ltd [2013] EWHC 348 (Ch)

Variable 2 – Year

Label: Case Year

Represents the year the case was heard.

Variable 3 – YearCat

Label: Pre versus Post 2008

The pre and post 2008 cases are coded in to categorical variables. Post 2008 cases are assigned the value 1 and pre 2008 are 0. A third category for pre-1982 cases, whilst considered, is not included due to the size of the dataset. 1982 saw the introduction of the Civil Procedure Rules (CPR) and introduced the requirements for a derivative claim to be permitted.

However, the main purpose of the study is to compare the old and new procedures. Therefore there are 21 cases heard under the new procedure. The remaining 27 cases are held under the old equitable procedure. The Companies Act 2006 introduced the new procedure. However, double derivative actions are still heard under the old equitable procedure. Therefore, two cases from this sample has been heard after 2008, when the 2006 Act came in to effect, but falls in to the old equitable procedure category.

Variable 4 – Prima facie_case

Label: Prima facie case

This looks to identify whether or not a prima facie case is made out. If there was a prima facie case then the value of 1 is assigned to the case. If not then the value 0 is assigned.

Whilst a prima facie case was not introduced until the introduction of the CPR the data is comparable as the rule still applied that majority rule and it is the company that enforces its rights. Thus a prima facie case is identified in pre-2008 cases by demonstrating whether or not the case falls within the proper boundaries of the exception to Foss v Harbottle.

A prima facie case post-2008 is defined by the Companies Act 2006, Part 11: 1) the individual must be a shareholder; 2) it relates to a right of action vested in the company; 3) in respect of a breach of trust, duty, negligence or default.

Whether a 1 is assigned is dependent on whether the case had advanced to the second stage of the proceedings and not on an assessment of whether I thought there was a prima facie case on the available evidence, based on the criteria above, or if a judge later claims or suggests there was not one on the evidence put forward at the second stage. Thus there is only not a prima facie case if it is specifically dismissed for that reason.

Variable 5 – Conduct_complaint

Label: Conduct covered by derivative claim

This variable concerns whether the conduct complained about by the claimant was the type of conduct covered by a derivative claim. i.e. equitable claims had to fall within an exception to the rule in *Foss v Harbottle*, normally fraud on the minority. Post-2008 cases must concern a breach of duty, trust, default or negligence. If the conduct was covered the value 1 was assigned. If the conduct was not covered then the value 0 was assigned.

Variable 6 – Mandatory_bar

Label: Mandatory Bar

Under Companies Act 2006, Part 11 a case must be dismissed if one of the mandatory bars is present. There is no comparable provision in the equitable procedure so data is only collected for statutory claims. Where the case was dismissed for a mandatory bar the value of 1 was assigned. Where there was no mandatory bar the value of 0 was assigned.

Variable 7 – Frivolous_Claims

Label: Frivolous Claims – Conduct covered

This variable is coded from variables 4, 5 and 6 to identify if a claim is frivolous. It is coded as a 0 if the claim was not frivolous and 1 if it was. Frivolous is determined based on whether there was not a prima facie case, whether there was a mandatory bar, or whether the conduct complained of was not covered by the procedure.

Given the differences in determining a prima facie case under the statutory and equitable procedure, it is notably easier to establish a prima facie case under the statutory procedure.

Therefore a claim was frivolous under the statutory procedure if it either: 1) lacked a prima facie case; 2) established a mandatory bar; or 3) the conduct was not covered by the procedure. Whereas a claim was frivolous under the equitable procedure if the conduct complained of was not covered. There were no mandatory bars under the equitable procedure so this could not be included for equity cases.

Variables 8-15

Labels: Good faith – discretionary item; section 172 – discretionary item; Approved – discretionary item; Company decision – discretionary item; Alt Remedy – discretionary item; independent – discretionary item; wrongdoer control – discretionary item; other – discretionary item

Once a prima facie case is established – and under the 2006 Act there are no mandatory bars – the court may still dismiss the action for a variety of reasons. Under the equitable procedure, pre-2008, derivative claims were a matter of grace, (see *Airey* at [72]) thus equity may disqualify the person bringing the claim from pursuing it. The new law is a matter of judicial discretion, under s.263(3). The new law guides the court to apply its discretion, whilst the old law it was simply a matter of grace, indicating some slight differences. However, both are phrased negatively that the courts look to see if there are any reasons to dismiss the claim. Therefore, these

“legal discretionary” factors are relevant and comparable as to whether permission is going to be given.

Under equitable procedure several factors have been identified by the courts as reasons to dismiss. The Act provides a non-exhaustive list of factors. Under the Act the following discretionary factors are listed. These are:

- 1) Whether the claimant is acting in good faith
- 2) How much weight a director acting in accordance with s.172 would attach to bringing a claim
- 3) Whether the action is going to be authorised or ratified
- 4) Whether or not the company has decided not to pursue the claim
- 5) Whether there is an alternative remedy
- 6) The views of members of the company who have no personal interest in the outcome

These are the 6 factors under the Act and are used as headings for the discretionary variables. There is also a heading for wrongdoer control. It was previously a bar to a claim if there was a lack of wrongdoer control, since in such cases it should be the right of the majority and the company to pursue the wrongdoer. However, under the new law it is only a discretionary factor that can be considered. Singling it out can inform the debate about the significance of this factor in derivative claims, since, as it is no longer a bar to a claim, it undermines one of the most basic principles of company law, that majority rule.

Under equitable procedure several factors have been identified from the cases studied. Most of these can be coded under the 2006 headings. These factors are:

- 1) Whether a reasonable board would consider it just for the action to proceed at the expense of the company
- 2) The solvency of the company
- 3) Whether there was an alternative remedy
- 4) Whether the conduct had been ratified or authorised
- 5) Whether the claimant had improper motives or an ulterior purpose
- 6) Independent views
- 7) Undue time wasting or delay
- 8) “equitable defences” available to the claim – see *African Tug* at 571 and per Browne-Wilkinson LJ – “A court of equity will not allow a minority shareholder to succeed... where there are equitable defences which, as between the shareholder personally and the defendants, the defendants could properly rely on in equity, e.g. the duty to elect between conflicting rights, acquiescence, or laches of minority shareholders

Where the discretionary factor considered does not fit under one of these headings then the final heading is ‘other_discretion’.

To determine whether a discretionary factor considered by the court is in favour or against permitting the claim the author’s judgment is used based on the available evidence. The judicial decisions are fairly clear on this since the court details those factors argued by the claimant and defendant and whether or not they are favourable. If the discretionary factor is in favour of the claim continuing then a value of 1 is assigned ‘for’ permission. If it is ‘against’ permission a value of 0 is assigned.

Variable 16 – StrongvWeak

Label: Strength of case

This was a categorical variable to measure the strength of the claim. There were 3 categories: Weak claims; middle claims; strong claims. A claim was 'weak' if there were no reasons to allow the claim. These were recorded as category 0. A claim was 'middle' if there were some reasons for and some reasons against permission. These were recorded as category 1. A claim was 'strong' if there were no reasons to dismiss it. These were recorded as category 2.

To determine the strength of a case under the equitable procedure and statute different criteria had to be applied for it to be comparable. For statutory claims this only included the discretionary factors. The amount of discretionary factors in variables 8-15 that the claimant had for and against permission were tallied up to determine whether their claim fell in to category 0, 1, or 2.

For the equitable procedure, strength of the case was coded using the discretionary factors and whether there was a prima facie case but excluded those claims that were frivolous.

This involved an analysis of 17 cases under the statute and 25 under the equitable procedure. It requires brief explanation that the court applied its discretion 17 times out of 19 when 6 cases were dismissed for a mandatory bar. This is because four of these statutory cases have either hypothetically considered the outcome if they were wrong about a mandatory bar and applied their discretion or, as in *Brannigan v Style*,¹ the court applied its discretion to some directors whilst dismissing the claim for a mandatory bar against others. These are included in the variables for individual discretionary factors and case strength.

Variable 17 – Permission

Label: Permission – successful derivative claim

This variable indicates whether the court gave the claim permission for the shareholder to continue the right of action. This is the main outcome variable. Where a 1 is assigned, permission was given. Where a 0 is assigned no permission was given.

Permission was defined where there was a successful outcome for the claimant.

Variable 18 – Type_of_company

Label: Company Form

This variable identifies the type of company involved by coding it in to a categorical variable. The categories and their values are:

1. Public limited company
2. Private limited company by shares
3. Other

Companies pre 1900 were generally only described as limited and were listed under 'other'. Whilst limited liability's meaning has not changed public companies have

¹ *Brannigan v Style* (2016), 2nd Feb 2016 unreported

grown in size and it would erroneous to compare public companies of today and categorise those companies in the 19th century as the same. Therefore they were categorised differently. Those categorised as 'other' also include unregistered companies, companies limited by guarantee, non-profit organisations, and unions.

Variable 19 – Shareholding_type

Label: Company Shareholding

This is a categorical variable identifying the nature of the shareholding between the claimant and defendant. The categories and their values are:

0. Minority claimant/majority defendant i.e. 2 shareholders only in the company
1. Equal share ownership
2. Majority claimant
3. Dispersed minority claimant/majority defendant i.e. where the two parties represent only part of the company's shareholding
4. Shareholder claimant/director defendant

The majority of cases concern a controlling shareholder as a director using their power for some means other than for the company. However, there are cases concerning claims brought purely against directors who are not also shareholders of the company. These are rare, particularly pre-2008 since it would be difficult to establish wrongdoer control if the wrongdoing directors were not shareholders. However, under the new law one must only be a shareholder to initially bring a claim.

Variable 20 – Conduct

Label: Conduct complaint – nature of complaint

This is a categorical variable identifying the nature of the conduct complained of. This is different from variable 5, which simply looks to see whether the conduct complained of was covered by the claim. This looks to categorise the particular type of complaint made. The categories and their value are:

0. other
1. Fiduciary Breach
2. Negligence
3. Other duty breach
4. Ultra Vires
5. Multiple claims

For types of conduct, 'fiduciary breach' was defined as a breach under what is now the Companies Act 2006, ss.175-177. 'Other breaches of duty' were defined as breaches under ss. 171-173. Negligence is section 174. Categorising on the basis of the duty was done to determine if the claim was more accessible to the new grounds under statute; but also because creating a category on fraud on the minority would not be directly comparable since this was not always in relation to a fiduciary breach.²

² See, *Daniels v Daniels* [1978] Ch. 406, 413-4

Variable 21 – Time

Label: Time in court days

These are continuous variables looking at how long the case lasted for. The variable is coded based on the claims hearing dates. Where these were not available from online databases or judgments, they were collected from solicitors who represented one of the parties. Only one case is missing so the variable consists of 45 cases rather than 46.

Variables 22-27 – Other_conduct; Fiduciary_Breach; Negligence; Other_duty_breach; Ultra_vires; Multiple_conduct

Labels: Other conduct – nature of complaint; Fiduciary breach – nature of complaint; Negligence – nature of complaint; Other breach of duty – nature of complaint; ultra vires – nature of complaint; Multiple conduct – nature of complaint

These are dummy variables based on ‘conduct’. Thus, in cases where there was a fiduciary breach a value of 1 is assigned to that variable. All other variables are assigned 0.

Variables 28-32 – MinorityClaimant_MajorityDefendant; Equal; MajorityClaimant; DispersedMinority_MajorityDefendant; ShareholderClaimant_DirectorDefendant

Labels: Minority claimant and majority defendant – Company Shareholding; Equal – Company Shareholding; Majority Claimant – Company Shareholding; Dispersed Minority and Majority defendant – Company Shareholding; Shareholder claimant and director defendant – company shareholding

These are dummy variables based on ‘company shareholding’.