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Shareholders are on the hunt...

A change in the law gives shareholders a new way to challenge directors

There have long been ways in which dissatisfied shareholders can challenge decisions made on behalf of a company by its directors. On 1 October 2007 a procedure came into being designed to provide 'more modern, flexible and accessible criteria for determining whether a shareholder can pursue such an action'. The Companies Act 2006 enables shareholders of a company to bring a claim challenging the actions of those running it if they allege that they are in breach of their duties as directors.

So why hasn't there been a flood of litigation by activist shareholders? This is undoubtedly due to the hurdles a shareholder must overcome during a two-stage permission process.

At the first stage a shareholder must demonstrate a prima facie case, considered by the court without hearing evidence from the company. If established, it moves to the second stage, when the court directs the company itself to give evidence.

HIGH HURDLES

The purpose of this two-stage process is to dispose of unmeritorious or frivolous claims early on. So far, no claims have made it past this stage.

Bircham Dyson Bell has just achieved a notable success for the National Landlords Association (NLA) in defeating a permission application. The NLA was one of six defendants in an application for permission to continue a claim against it. The claim arose from a boardroom dispute involving one of the claimants who was determined to challenge the merger.

In July 2008, the NLA and the National Federation of Residential

Landlords (NFRL) merged to form the largest landlord association in the UK. The merger was welcomed across the industry as an important step towards a unified voice for landlords at the national level. Shortly after the merger was announced, 11 members of the NFRL started legal proceedings against the NLA and the majority NFRL directors who were in favour of the merger. For nine months, the NLA was compelled to adhere to a number of strict High Court undertakings, hindering it from effectively representing and assisting landlords who were members of the NFRL.

In May 2009, the High Court dismissed the legal challenges to the merger. It also ordered those who brought the action to pay the NLA's costs.

The application was not only one of the first cases to come to court concerning whether or not permission should be granted to bring a derivative claim under

the new Act, but also – somewhat unusually in the context of derivative claims – involved two trade associations. These associations are companies limited by guarantee rather than by shares, a structure common to non-profit-making organisations such as these.

The claimants also sought sequestration of the NLA's assets for an alleged contempt of court in purported breach of various undertakings following an injunction application, but dropped this claim shortly before the hearing. Costs were awarded to the NLA on an indemnity basis.

So how can directors avoid derivative claims being brought against them? The short answer is to make sure that they are

aware of and comply fully with their duties as directors. The 2006 Act codified directors' duties, largely (but not completely) replacing the former legally recognised list of duties. These include duties to exercise independent judgement and reasonable care, skill and diligence.

All directors should acquaint themselves thoroughly with the detail and extent of their duties and comply with them fully; by doing so they will minimise the possibility of a derivative action coming their way. ■

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