

**Neutral Citation Number: [2009] EWHC 2072 (Ch)**  
**IN THE HIGH COURT OF JUSTICE**  
**CHANCERY DIVISION**

Case No: 7571 of 2008

Royal Courts of Justice  
Strand  
London WC2A 2LL

Thursday, 21 May 2009

BEFORE:

**HIS HONOUR JUDGE PELLING O.C.**  
**(Sitting as a Judge of the High Court)**

BETWEEN:

- 
- (1) MICHAEL STIMPSON
  - (2) MAXINE FOTHERGILL
  - (3) ALFRED KNIGHT
  - (4) SHULA RICH
  - (5) RICHARD CLARK
  - (6) MALCOLM CLARK
  - (7) JOHN PETTMAN
  - (8) JOHN THORPE
  - (9) ANDREW LITTLEWOOD
  - (10) GERTRUDE BYRNE
  - (11) ALAN GOSS

**Claimants/Applicants**

-and-

- (1) SOUTHERN PRIVATE LANDLORDS' ASSOCIATION
- (2) BARRY MARKHAM
- (3) KENNETH GROVES
- (4) MICHAEL COHEN
- (5) ANTHONY RICHARD
- (6) NATIONAL LANDLORDS' ASSOCIATION

**Defendants/Respondents**

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MR D BROMILOW appeared on behalf of the Applicant  
MR I GREENWOOD appeared on behalf of Second to Fifth Respondents  
MR A THOMPSON appeared on behalf of Sixth Respondent

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**Approved Judgment**  
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## JUDGE PELLING QC:

1. There are two applications before me, each of which was issued on 4 September 2008, being:

- (a) an application by the claimant for permission to continue a derivative claim pursuant to section 261 of the Companies Act 2006 (“the 2006 Act”); and
- (b) an application for an interim injunction.

The first of these applications came before Evans-Lombe J on 18 March 2009 when he directed that a questionnaire be sent to members of the first defendant – the company in whose name the claimant wishes to bring the proposed proceedings. The second application seeks, in effect, a continuation of the relief granted by Briggs J on 18 September 2008. It has been agreed that I should determine the application for permission first.

2. Derivative proceedings are now governed by Chapter 1 Part II of the 2006 Act. The procedural framework is set out in sections 261 and 263 of the 2006 Act. Section 261 contemplates a two-stage process with the Court considering the application initially without notice. If the court considers that the application does not disclose a prima facie case for giving permission, the court must dismiss the application at that stage - see section 261(2). If the application is not dismissed at that stage then there is a hearing at which all parties are entitled to be heard and at which the court may either give or refuse permission, or adjourn, or give directions - see section 261(4).
3. In these proceedings the first stage has not taken place and there has been instead just the contested hearing before me at which all parties have been represented and for which a substantial volume of written evidence has been filed by all parties. Although the defendants suggest that I should stick to the two-stage process and start by asking myself whether a prima facie case has been made out, I consider that to be unduly elaborate in the circumstances of this case. I prefer to approach the application by reference to section 263 of the 2006 Act as if the case had been considered initially because that reflects the procedural as well as the practical reality and will yield the fair and proper result.
4. In deciding the application for permission, the court is required to dismiss the application if either:
  - (a) a person acting in accordance with section 172 of the 2006 Act (being the section that imposes a duty to promote the success of the company) would not seek to continue to claim; or
  - (b) where the act or omission from which the course of action is alleged to have arisen was either authorised by the company before, or ratified by the company after, it occurred

- see section 263(2), Companies Act 2006.

Aside from this requirement, in deciding whether to give permission, the court is required to take into account each of the matters identified in section 263(3) of the 2006 Act to the extent they are relevant. It is common ground that the factors referred in section 263(3)(c),(e) and (f) are not relevant. Thus there are three factors which the court is required to take into account along with any other relevant factors not specifically identified in section 263(3) being:

- (a) Whether the applicant member is acting in good faith in seeking to continue the claim (s.263(3)(a));

- (b) The importance that a person acting in accordance with section 172 of the 2006 Act would attach to continuing the claim (s.263(3)(b)); and
- (c) Whether the act or remission complained of could be, and in the circumstances would be, likely to be ratified by the company (s.263(3)(d)).

As to (b) the only guidance as to the correct approach is that contained in the judgment of Mr William Trower QC sitting as a judge of this court in Franbar Holdings v Patel and others [2008] EWHC 1534 Chancery, where he said:

“In my judgment, the hypothetical director acting in accordance with section 172 would take into account a wide range of considerations when assessing the importance of continuing the claim. These would include such matters as the prospects of success of the claim, the ability of the company to make a recovery on any award of damages, the disruption which would be caused to the development of the company's business by having to concentrate on the proceedings, the costs of the proceedings and any damage to the company's reputation and business if the proceedings were to fail. A director will often be in the position of having to make what is no more than a partially informed decision on continuation without any very clear idea of how the proceedings might turn out.”

5. This dispute is concerned with the first defendant, a company limited by guarantee, whose function it was to represent the interests of private landlords by lobbying on behalf of its members, providing advice and assistance to its members, and also providing facilities such as insurance and mortgages for the benefit of its members by negotiation with the commercial providers of such services. Members are members for each year for which they pay an annual subscription. If they fail to pay the subscription they cease to be members one month after the subscription has become due. The first defendant is one of a small number of organisations that provide similar services. Another, and larger, provider is the sixth defendant, also a company limited by guarantee.
6. The first claimant was a founder of the first defendant. The remaining claimants are members of the first defendant who support the first claimant. The first claimant is the president and a director of the first defendant whose voting capacity was, however, at all material times limited to breaking deadlocks on the Board. The second to fourth defendants were statutory directors of the first defendant together with Mrs Ruth Kerslake. The fifth defendant was purportedly appointed a director of the first defendant. However, the validity of the fifth defendant's appointment is hotly in dispute between the parties. It is accepted that, on any view, he was a shadow director from the date of his purported appointment.
7. The dispute between the parties is the culmination of much in-fighting within the organisation of the first defendant and has become a morass of detail. However, in essence, the first claimant contends that the second to fifth defendants, and in particular the second defendant, have engineered the transfer of all the assets of the first defendant to the sixth defendant, in breach of the duties owed to the first defendant as directors pursuant to sections 172, 175 and 177 of the 2006 Act, contrary

to the wishes of a substantial number of its members and contrary to provisions of the first defendant's memorandum and articles of association. Sections 172, 175 and 177 of the 2006 Act together are a partial codification of the fiduciary duties owed by company directors to the companies of which they are directors. The claim against the sixth defendant is advanced on the basis that the sixth defendant holds the assets of the first defendant on trust by reason of knowledge of the sixth defendant's controlling minds of the breaches of duty by the second to fifth defendants allegedly acquired prior to the transfer of the first defendant's assets to the sixth defendant. Against that background I now turn to the detailed facts.

8. The first defendant is as I have said a company limited by guarantee. The objects clause within its memorandum of association identifies its purposes as being:

“(a) To provide a forum for consideration of matters relating to the letting of private properties and to promote a professional standard of practice and conduct by all its members for the benefit of the private rented sector as a whole;  
(b) To represent the general views of the members to local authorities, national authorities, parliament and any other body which has jurisdiction over or an interest in the letting of private properties;  
(c) To consider any matters which affect private landlords in general and to promote such actions that will benefit the members and safeguard their interests consistent with the maintenance of professional standards of conduct;  
(d) To provide advice and assistance to members in connection with problems relating to the letting of properties;  
(e) To promote the professional standing of the Association within the private rented sector;  
(f) To provide and support such social and charitable events as the Association may decide, and  
(g) The doing of all such other things as are incidental or conducive to the attainment of the above objects.”

9. Clause 4 confers power on the first defendant in furtherance of its objectives to:

“(d) to federate or amalgamate with, affiliate or become affiliated to or co-operate with any body having the same or similar objects and to acquire and undertake all or any part of the assets, liabilities and engagements of any such body which the Association may lawfully acquire or undertake.”

By clause 5 of the memorandum:

“The income and property of the Association shall be applied solely towards the promotion of the Objects and no part shall be paid or transferred, directly or indirectly, by way of dividend, bonus or otherwise by way of profit, to members of the Association.”

and by clause 8 of the memorandum:

“If the Association is wound up or dissolved and after its debts and liabilities have been satisfied there remains any property it shall not be paid to or distributed among the members of the Association, but shall be given or transferred to an association or associations having objects similar to the Objects which prohibits the distribution of its or their income and property to an extent at least as great as that imposed on the Association by clause 5 above, chosen by the members of the Association at or before the time of dissolution and if that cannot be done then to some other charitable object.”

These clauses are relied upon by the respondents to the application because they say it shows that one of the bases of the application - that the members have been deprived of the first defendant's assets - is misconceived since the members have no entitlement to the assets either before a winding up - see clause 5 of the memorandum - or after - see clause 8 of the memorandum.

10. The articles are largely as one would expect for a company of this sort. They provide for an AGM (see clause 5). There is a power vested in the executive committee (the phrase used to describe the board of directors) to call EGMs and an obligation to convene an EGM is imposed if such is requested by the members pursuant to the Companies Act 2006 (see clause 6). The number of directors is fixed at between four and seven (see clause 27) together with the president (at the material time the first claimant) but the president is empowered to vote only as a tie-breaker (see clause 28(2)). The business of the company was required to be managed by the executive committee who were empowered to exercise all the powers of the company subject to any directions contained in a special resolution. The powers of the executive committee were exercisable either by that committee as a whole or quorate part (see clause 29). By Clause 43, a quorum was defined as being four executives, one of whom had to be an office holder, which by prior express definition included the president, chairman, vice-chairman and various other office holders. Although the power of appointing directors rests primarily with the members, by clause 37 of the articles the executive committee is empowered to appoint additional directors up to the maximum number fixed by the articles. An executive can be removed from office under clause 39 of the articles if he or she:

“ ... is absent without the permission of the Executive Committee from 50% of the general meetings and Executive Committee meetings held within a calendar year and the Executives resolve that his office be vacated.”

The executive was empowered to regulate their proceedings as they thought fit (see clause 42). Thus, they were entitled to adopt standing orders but, equally, were entitled to vary or revoke such orders or depart from them as a majority attending a quorate meeting of the executive might consider appropriate.

11. The claimant maintains that on 29 February 2008 the executive committee adopted some “operational rules” to regulate the conduct of meetings of the executive committee. The second to fifth defendants accept that these rules were adopted in principle. One of these rules required an agenda to be emailed to Board members no later than one week prior to the date of the Board meeting.
12. The events that give rise to the application start with the 2008 AGM that was held on 4 April 2008. At that meeting the following resolution was passed by 94 percent of the voting membership:

“That the executive committee be authorised with immediate effect to begin formal negotiations with other national landlords’ associations and if in the opinion of the executive committee it is in the best interests of members and the company to do all such acts and things to federate, merge or amalgamate with, affiliate or become affiliated to, or co-operate with any body having the same or similar objects as the company and to (1) acquire and undertake all or any of the assets liabilities and engagements of any such body; (2) sell, dispose or transfer all or any of the assets, liabilities and engagements of the company to any such body.”

(Quote unchecked)

The minutes record that the result was announced at 1.30pm following a poll. The following appears in the minutes after the passing of the resolution is recorded:

“(3) The Board gave an undertaking that further consultation on resolution 3 would be conducted and that should members want to vote before proceeding, members would be allowed to express their thoughts on the merits of any potential merger by way of a voting procedure.”

(Quote unchecked)

13. It is contended by the claimants that the resolution quoted above was obtained on the basis of the undertaking set out above. I reject that suggestion because: (a) the offer of such an undertaking was not contained in the papers circulated prior to the meeting; (b) the undertaking was not on any view offered to those voting by proxy, which constituted the vast majority of those voting in favour of the resolution - 982 votes were cast but only 33 members attended the AGM in person - and (c) what is suggested is inconsistent with the terms of the minutes which suggests that the undertaking was given after the vote had been completed. Although there was a suggestion that the proxy votes were all discretionary proxies which gave the second defendant the opportunity to vote as he chose, the evidence clearly shows that not to be so. Some reliance was also placed by the claimant on an email from the second defendant to a member dated 28 March 2008. It is said that this promised consultation at all stages but was not honoured. However, I do not regard the email that is relied upon as being material for present purposes because it is addressed to a single member and pre-dates the general meeting on 4 April 2008 at which the resolution, to which I have referred above, was passed.

14. Following the AGM, negotiations were commenced by the second defendant with the sixth defendant. There is a dispute as to whether any contact was made with any organisation other than sixth defendant which I am not able to resolve on an application of this kind and which is not of central importance. The contact resulted in a first draft heads of agreement that was circulated to all the then directors with the exception of the first claimant. It is clear that by this time the first claimant had developed a firm view that union with the sixth defendant should not proceed. However, no coherent reason for this has been advanced by him. The material before me that goes to this issue suggests that, objectively, the merger was one that benefited the members, not least because it gave them access to a large organisation providing services which were the same as, or more extensive than, those provided by the first defendant and at a lower annual cost. The defendants maintain that the inference is that the first claimant was and is motivated by a desire to maintain or regain control of the first defendant, which he founded and which he had been involved with for many years and to do so without regard to the objective best interests of the members. This point has been highlighted in the evidence and has not been answered. No attempt has been made by the claimant to explain why substantively the merger of the first defendant with the sixth defendant is not in the interests of the members. The claimant's case is advanced exclusively by reference to points of process rather than substance. There is some evidence (referred to below) of significant in-fighting at director level which has absorbed funds and distracted attention from the provision of services to members.
15. I accept the submission of the defendants that, inferentially, Mrs Kerslake was the claimant's ally. I say this because there came a point when the first claimant decided to stop attending Board meetings in order to prevent such meetings being quorate and so stifle the conduct of the claimant's business. The Claimant accepts that this could only work if (as occurred) Mrs Kerslake also did not attend. This was, in my judgment, admitted conduct on the part of the first claimant which was in breach of the claimant's duties to the company imposed by Section 171 and following of the 2006 Act.
16. Two key board meetings took place on 23 June 2008 and 30 June 2008. It is these meetings that form the foundation of the claimants' case. The contentious issue at the meeting on 23 June was the appointment of Mr Harrison as an additional director. The Board plainly had powers to adopt this course. The agenda for the meeting on the 23 June is at bundle 4 page 435. It does not contain, expressly, a proposal for the appointment of Mr Harrison as an additional director. That document reflects the degree to which the first defendant was riven with in-fighting which had as its effect the diversion of attention and resources away from the objects of the organisation. There are cross proposals contained in the agenda by the first claimant and the second defendant for votes of no confidence in the other and a proposal that company funds be used to meet the costs of litigation between the first claimant and the various officers of the company, including the second defendant. As the minutes (File 4 page 140) reflect, the 23<sup>rd</sup> June meeting was inquorate when it started. It is common ground that an attempt was made to contact Mrs Kerslake by telephone with a view to creating a quorate meeting, since directors were permitted to attend by phone. This is reflected in the minutes.

17. There is however one critical issue between the parties. Whatever may have happened after Mrs Kerslake was contacted by telephone, she maintains that she told the meeting that she was not prepared to consider the appointment of Mr Harrison and that she ended the call before any vote concerning the appointment of Mr Harrison had been taken. The minutes suggest that a formal vote on the appointment of Mr Harrison had been taken before Mrs Kerslake ended the call. It is accepted by all defendants that a quorate meeting could become inquorate by the withdrawal of a director from the meeting. Thus, if Mrs Kerslake is correct, then the meeting became inquorate before the proposal to appoint Mr Harrison as a director could have been voted on. This leads Mr Thompson at least to concede that there is an arguable, though he would submit barely arguable, issue as to whether Mr Harrison was validly appointed. He submits however that there is substantial and significant risk, which any hypothetical director would be bound to take account of, that the court would reach a contrary conclusion. Whatever the merits of the evidence of Mrs Kerslake as against that of the various directors who were present at the meeting, clearly Mr Harrison had doubts concerning the validity of his appointment following the taking of legal advice (see his email of 29 June 2008, file 4, page 449).
18. The significance of this point is that it was only by reason of the attendance of Mr Harrison at a meeting on 25 June 2008 that a further additional director, the fourth defendant, was purportedly appointed. If Mr Harrison's appointment was invalid then so was that of the fourth defendant. A further meeting took place as I have said on 30 June 2008. It was that meeting that purported to authorise the second defendant to sign the agreement which the first claimant seeks to challenge. However, that meeting was only arguably quorate because of the presence of the fourth defendant at it. If he was not validly appointed then that meeting was inquorate and no authority was validly given to the second defendant to sign the agreement.
19. The agreement that is objected to by the claimant is dated 8 July 2008. By clause 2 of the agreement it was provided that:

“Unless expressly provided in this agreement, SPLA shall transfer with full title guarantee, or to the extent that it is not the owner thereof shall use reasonable endeavours to procure the transfer with full title guarantee, and NLA, with a view to carrying on the Business as a going concern, shall acquire the Business and Assets free from all Encumbrances and with effect from the Effective Time.”

By clause 2.3, cash was excluded from the assets transferred under the agreement. What was to happen in relation to the cash was the subject of a side letter. Clause 3 of the agreement provided that

“In consideration for the acquisition of the Business and Assets the NLA shall assume from SPLA all Assumed Liabilities relating to the Business and the Assets as exist immediately at the Effective Time and Members of the SPLA will benefit from increased lobbying power as a result of the merger.”

Clause 8.2 of the agreement provided that:

“NLA shall with effect from the Completion Date indemnify the SPLA Directors from and against all losses, costs, or expenses which any of them may suffer or incur (including without limitation, professional costs reasonably and properly incurred on a full indemnity basis) as a result of or in connection with all acts or omissions of the SPLA Directors prior to the Completion Date.”

By Clause 11.1 of the agreement:

“Two directors of SPLA (reverting to one director of SPLA if less than 4,000 Members transfer to NLA by the date of the NLA AGM in November 2008) will be offered directorship positions on the NLA board, with role descriptions to be agreed between the parties (acting reasonably and in good faith).”

Various restrictive covenants were entered in to which are set out in clause 15 of the agreement and which, if enforceable, would prevent the first defendant from resuming independent operations.

20. The side letter relating to the cash is written on the letterhead of the NLA and is dated 12 August 2008 (bundle 6, page 1179). It is signed by Mr David Salisbury, on behalf of the NLA, and by the second defendant, on behalf of the first defendant. It provides that:

“on completion of the business acquisition agreement between our associations we make further provisions for the use of the SPLA cash balances which will be transferred within 28 days of completion to the NLA:

- (1) The SPLA cash balances that are transferred will be kept in a separate, designated account.
- (2) The two SPLA directors who become directors of the NLA under the terms of the acquisition agreement will be signatories to this account, together with the NLA Chairman and the NLA Director of Finance. Withdrawals from the account will require one signature from each of the two pairs of signatories.
- (3) The SPLA funds will be used to enable NLA to meet its obligations for the provision of advice, information, meetings, representation, and services which have been assumed on behalf of the SPLA.
- (4) The SPLA-nominated directors may also approve expenditure from this account for purposes other than those prescribed above provided such expenditure is consistent with the aims and objectives of the NLA.

- (5) The NLA Director of Finance will maintain a record of all transactions, which will be included in routine financial reports to the NLA Board.

This letter is intended to be legally binding.”

The evidence suggests that some £200,000 was to have been or was transferred from the first defendant to the sixth defendant.

21. The claimant’s case is that this agreement was at least arguably signed without authority, was entered into by the second to fifth defendants in breach of their various fiduciary duties as identified in Sections 171, 172, 175, and 176 of the Companies Act 2006 and an account of profits and/or equitable compensation is sought as against the second to fifth defendants. No one suggests that the actual profits made were anything other than some modest directors’ fees paid to two of the first defendant’s directors for the short period that they were directors of the sixth defendant, totalling less than £2,000. As to equitable compensation, this is sought in respect of the loss of the assets identified in Schedule 1 to the agreement and the cash. It is common ground that attempting to put a value on the assets would be enormously difficult and that, in practice, the claim is likely to be of limited value. For reasons that will become apparent it certainly does not have the value of £5.3 million that was alleged by the first claimant in his witness statement in support of the application. As against the sixth defendant it is alleged that it holds everything transferred to it from the first defendant on constructive trust on the basis that its receipt was unconscionable because it knew of the breaches of fiduciary duty and the lack of authority of the second to fifth defendants via Mr Salisbury, one of its directors, and also via the two directors of the first defendant who became directors of the sixth defendant. This is very strongly disputed as even arguable by the sixth defendant.
22. Permission must be refused if the court is satisfied either that a hypothetical director acting in accordance with Section 172 would not seek to continue the claim or where the course of action arose from an act or omission which was authorised by the company before it occurred. The Defendants rely on both these grounds. I turn to the last of these two grounds first.
23. I reject the suggestion that the application must be refused by operation of Section 263(2)(c) for the following reasons. Whilst it is true to say that all the defendants maintain that the second defendant was given authority to sign the agreement by the directors at the meeting on 30 June, it is on the evidence at least arguable that was not so because the fifth defendant was arguably not validly appointed at the meeting on 25 June, because arguably Mr Harrison was not validly appointed on 23 June. That is so, because arguably Mrs Kerslake was not present on 23 June for the relevant part of the meeting. This point is arguable regardless of whether the meeting on 25 June was invalid because it took place so soon after the meeting on 23 June that an agenda could not be circulated within the time provided by the operational rules. The alternative way in which it is suggested by the Defendants that authority had been given was by reference to the resolution passed at the General Meeting on 4 April. In my judgment this point does not assist the Defendants. Whilst the making of the agreement was within the scope of the resolution because it was an act to sell, dispose or transfer all the assets, liabilities and engagements of the

company, the resolution vested the power to do those acts in the executive committee. That can only mean either the whole executive committee for the time being or a quorate part of it. Thus, if the claimants are correct and the meetings of 23 June, 25 June and 30 June were all inquorate, then the resolutions cannot be relied upon for the purpose now under consideration.

24. Thus the real first question to which I now turn is whether a hypothetical director acting in accordance with Section 172 of the 2006 Act would not seek to continue the claim.
25. It is to be borne in mind that the vast majority of cases in which permission is sought will concern companies limited by shares that are trading companies whose members will be shareholders. However, this case does not concern such a company. The first defendant is a company limited by guarantee, it is not a trading company and, as counsel for the second to fifth defendants put it, its members are transient affiliates who are members only for so long as they pay their subscriptions. It is a not-for-profit organisation which is in reality a trade association and one, what is more where the members do not have any interest in its assets.
26. Section 172(1) refers to the requirement that a director must act in a way he considers would most likely promote the success of the company for the benefits of its members as a whole. However, that provision has to be read subject to Section 172(2). This provision contemplates two different situations - that where the objects of the company consist of purposes other than the benefit of its members and that where the purposes of the company include purposes other than the benefit of its members. In relation to the first of these situations, Section 171(1) is to be read as providing that a director must act in a way that he considers in good faith would be most likely to achieve those purposes. Although it was suggested by the defendants that the first of these constructions applies to both of the situations I have identified and that such a construction would have an impact in the circumstances of this case, I reject that submission. To adopt such an approach would be to apply a test that would be entirely inappropriate to a company with mixed objects because it would require the benefit of its members to be ignored (even though the benefit of members was one of its objects) or subordinated to the other objects. Such a test would be progressively more inappropriate depending on how relatively unimportant the other objects were both on a consideration of the relevant objects clause and as a matter of practicality. In my judgment Section 172(1) is to be construed as meaning that a director of a company with mixed objects must act in a way that he considers in good faith would most likely promote the success of the company for the benefit of its members as a whole whilst at the same time achieving its other purposes. Where there is a conflict between promoting the success of the company for the benefit of its members and the achievement of the other objectives, a balancing exercise will be required.
27. As I have said the objectives of the first defendant are set out in clause 3 of its memorandum of association set out above. A perusal of the objects identified shows a mixture of objects or purposes. Clause (a) refers in particular to:

“Provide a forum for consideration of matters relating to the letting of private properties and to promote a professional standard of practice and conduct by all its

members for the benefit of the private rented sector as a whole.”

Similarly paragraph (f) provides for a purpose other than the benefit of the members, other than perhaps incidentally. In my judgment however, the objects other than those that provide directly for the benefit of the company’s members are very much the minority. Moreover, there is no evidence that shows in practice that either of these objects played a significant role in the activities of the first defendant. Thus the effect of Section 172(2) on the outcome of this case is unlikely to be significant.

28. Deciding whether a hypothetical director acting in accordance with Section 172 of the 2006 Act would not seek to continue the claim necessarily involves considering those issues identified by Mr Thrower QC in Franbar - that is (a) the prospects of success, (b) the ability of the company to make a recovery, (c) the disruption that would be caused to the company by the commencement or continuation of proceedings and (d) the cost of such proceedings. However, that list is not and was not intended to be comprehensive. In a case such as this answering the question under consideration also involves considering the ability of the company to provide benefits to its members after completion of the litigation, the degree to which delay in completing the litigation would affect the ability of the company to provide services for its members at all, and the degree to which the company can expect to retain members during the litigation, or regain them after it has been completed, bearing in mind that the only income that the first defendant has ever had is its subscription income.
29. I start therefore, as would a hypothetical director by considering the causes of action available to the company. Aside from the quorum point to which I refer further below, it is said first that the directors acted in breach of Section 172 of Companies Act 2006 because in effect they gave away the company. In my judgment, a properly advised director would reject this as a realistically arguable claim. This was not a trading company. It was a not-for-profit service provider. The board had been directed by a properly passed resolution of a general meeting of the company to seek a merger or amalgamation of the company with another. In practical terms the only way a merger or amalgamation could be achieved was by transferring the undertaking of the first defendant to the sixth defendant or another willing merger partner, or by the sixth defendant or other willing merger partner transferring its undertaking to the first defendant. Indeed those are precisely the alternatives reflected in the resolution passed at the AGM in April 2008. The members did not have shares. All they had was an obligation to contribute by virtue of their respective guarantees and to receive the services to which they were entitled by contract. They were entitled to receive services only as long as they paid their subscriptions. Thus, if the undertaking of the first defendant was transferred to the sixth defendant on terms that provided for its members to get services that were the equivalent of or better than those provided by the first defendant for the duration of the period covered by their current subscriptions, then I do not see how it could be contended that there was a transfer at an undervalue or for no value, so far as the members were concerned. The assets have been transferred as part of an overall arrangement which enables the member to receive the same or better services without additional charge. The evidence that the services to be provided were equal to or better than those provided by the first defendant is not challenged by the claimants in any persuasive sense. Thus I consider

that a director properly advised would conclude that this claim was a hopeless one, viewed on its own and aside from the quoracy issue.

30. Likewise, a claim based on an alleged breach of duty imposed by Section 175 has no realistic prospect of success for in truth there was no conflict of interest that arose here or at any rate one not covered by Section 175(4)(a). The only conflict relied upon is that two of the directors of the first defendant became directors of the sixth defendant before formal signature of the agreement in July. However, they became directors, so the defendants say, on the day when the sixth defendant's Board had approved the signing of the contract and after that approval had been given. The fact that the persons concerned were to be appointed directors was plain on the face of the agreement - see clause 11.1 and also see clause 2 of the side letter. In my judgment, a director would conclude that a cause of action based on these allegations, as against the second to fifth defendant, was not realistically arguable or at best was only barely so.
31. Next I turn to the suggestion that there has been a breach of Section 176 of the 2006 Act. It is to be noted that the duty under this provision is qualified by Section 176(4) and the duty will not be breached if the benefit cannot be regarded as likely to give rise to a conflict. The benefits here relied upon are: (a) the suggestion that those of the second to fifth defendants who were not to become directors of the sixth defendant would receive compensation for loss of office from the sixth defendant; (b) the payment of directors' fees to the two directors of the first defendant who became directors of the sixth defendant in a total sum of £2,000 or less; and (c) the provision of the indemnity for the second to fifth defendants in the agreement which I have set out above.
32. The first of these points can be dismissed straightaway simply because it did not form part of the agreement, was not the subject of any separate agreement and did not happen. The second can be dismissed on the basis that: (a) it could only be relevant to the two directors concerned; (b) the sum concerned were so small and sufficiently widely known as to be incapable of reasonably being regarded as likely to give rise to a benefit; and (c) in any event no director properly directing himself in accordance with Section 172 would commence proceedings to recover a sum of £2,000 or less. That leaves the indemnity. As to that: (a) it was apparent on the face of the agreement and (b) it is entirely the sort of clause one would expect in a transaction of this sort and is consistent with the assumption of the sixth defendant of the liabilities of the first defendant and the remaining directors of the first defendant leaving office. The company is not in any sense deprived of its cause of action against its directors since all the clause does is provide an indemnity to those directors for their benefit. It is thus strongly arguable that the duty has not been infringed. Indeed, but for the quoracy point I cannot see any prospect of this point being raised independently. Thus, at best, a director properly advised would be remarkably cautious about proceeding by reference to this point alone given the very technical nature of the points made and the overall circumstances.
33. Thus, there remains the only realistically arguable point, which is that the second to fifth defendants proceeded knowing that the meetings of 23 June, 25 June and 30 June were all tainted by inquoracy, traceable back to the events of 23 June. However, the fact that the agreement was entered into by an inquorate section of the Board is not of

itself sufficient because Section 260(3) of the 2006 Act limits derivative claims to causes of action arising from a breach of duty. Thus, a claimant will have to show that the second to fifth defendant acted in breach of one of the statutory duties referred to above by signing the agreement. In my judgment it is realistically arguable that a director who purports to sign an agreement knowing that he has no authority to do so, because the authority he has been given was granted by a section of the Board which was not quorate, would breach the duty to act in accordance with the first defendant's constitution, contrary to Section 171 of the 2006 Act. As I have said, the articles of the first defendant make it entirely clear that the affairs of the company are to be conducted by the Board or a quorate element of it. Thus a director acting in accordance with Section 172 and properly advised would accept that the first defendant has a cause of action to this extent. The director would be bound to consider however, the strength of that cause of action and would note the rival contentions of (a) the second to fifth defendants and (b) Mrs Kerslake, would note the existence of documents coming into existence after the meeting of 23 June, which arguably suggest that Mrs Kerslake may be correct, but would also note that authority was granted at the meeting on 30 June only following a meeting with lawyers who by implication advised it was safe to proceed. The hypothetical director would note however that the nature of the instructions given, and the advice sought and given, is nowhere set out and thus a doubt exists as to: (a) what the solicitors were told; and (b) what advice the solicitors gave. A hypothetical director would note the existence of clause 47 of the articles of association and would note it could not apply if the relevant defect was known before the act to which it is sought to apply the article.

34. However, the existence of a realistically arguable claim is not sufficient. The claim, as it is advanced against the second to fifth defendants, is primarily for equitable compensation. The claim formulated in this way has no prospect of leading to the recovery of £5.3 million as alleged by the claimant and a director acting in accordance with Section 172 and properly advised could not properly come to such a conclusion. The first claimant's reasoning in relation to the figure of £5.3 million is set out at paragraph 68 of his witness statement but does not withstand analysis because it assumes that the true value of the first defendant was to be calculated by applying a multiplier of 5 to its annual subscription income less its overhead at the date of the agreement. There is no evidence to justify such an approach before me. Not merely is the subscription income not profit (it being substantially expended on the provision of services for its members as well as its necessary overheads) but also this approach assumes that the members are tied in or will, in all likelihood, continue as members from year to year. There is no evidence that proper valuation techniques would value the income derived from a precarious membership of the sort the first defendant had by the application of a multiplier of 5, much less that a willing purchaser would pay a price calculated on this basis for the first defendant.
35. This is all relevant because a director properly advised and directing himself in accordance with Section 172 might consider it appropriate to continue a claim with a realistic prospect but attended by the difficulties I have referred to if there was a realistic prospect of recovering in excess of £5 million but if the sums likely to be recovered were significantly lower than this. In my judgment there is no realistic prospect that a sum of in excess of £5 million would be recovered by the company for the reasons I have given. The reality is that the claimant can only expect at most to recover the value of the assets transferred to the sixth defendant. As to that £200,000

has been transferred but by the same token, significant liabilities of the first defendant have been discharged. The balance, aside from the cash, is the value of the assets transferred, most of which are intangible. The database of members is unlikely to be of any significant commercial value but will, I accept, have some. Its valuation will however be a difficult process, evidentially. The other assets will be more difficult still to value.

36. At this point it is necessary to consider the claims against the sixth defendant because if the assets transferred to the sixth defendant can be returned with relative ease, and the first defendant has a viable cause of action against the sixth defendant then the loss point so far considered would be of more limited significance. The claim against the sixth defendant is that it holds the assets on constructive trust for the first defendant because it was a receiver of the assets knowing them to have been transferred in breach of fiduciary duty. As to the breach of fiduciary duty, it is realistically arguable that the second to fifth defendants acted in breach of fiduciary duty by authorising the signature of the agreement when they knew that the Board meeting at which the resolution to authorise signature was inquorate. However, as against the sixth defendant, article 47 of the articles of association becomes important because if the effect of that provision is to be avoided as against the sixth defendant, it must be asked whether the sixth defendant only discovered the defect after the signature of the agreement. That again depends on what was said on 30 June to Mr Salisbury concerning the problem, what the lawyers said and whether Mr Salisbury was entitled to rely upon the advice of the first defendant's or alternatively the second to fifth defendants' solicitors, rather than taking his own advice. However a hypothetical director would be bound to take into account the fact that the sixth defendant has an apparently seriously arguable case by reference to this provision. Against this background the hypothetical director properly advised and properly directing himself would in my judgment ask himself whether there was a realistic prospect of establishing unconscionability on the part of the sixth defendant. He would conclude that the outcome must be regarded as speculative in the circumstances. However, if the claim were to succeed on the issue of liability, there would be a viable claim for the return of the cash transferred possibly less the liabilities settled which I am told amount to about £130,000, and at least the tangible assets of the company including its rented office accommodation.
37. It is worth noting in passing, however, that six employees were transferred to the sixth defendant on the merger. Three of those employees have ceased being employed by the sixth defendant but three remain and for them the prospect is bleak - for if the transaction were reversed it is likely they would be made redundant from the sixth defendant with no necessary prospect of being re-employed by the first defendant. The significance of a point such as this is very fact sensitive, but it is nonetheless one that is relevant here at least when considering whether to give permission because Section 263(3) is not exhaustive and here a relatively small number of employees are at risk when in reality the members of the first defendant are not, for they were provided with services at least as good as those formerly provided by the first defendant, down to the date their subscriptions expired at no additional cost and can obtain continuing services by paying a subscription to the sixth defendant which in fact is less than that that was charged by the first defendant.

38. Aside from the merits of the claim and its likely value there are other factors which a hypothetical director would be bound to take into account in deciding whether or not to continue with the claim. I set these out in no particular order.
39. First, consideration has to be given to costs. The first issue that arises is how the litigation is going to be funded down to completion. It is said that the first claimant is wealthy and can and will fund it. That may be satisfactory to an extent, but there is a foreseeable risk that for reasons that may not now be foreseeable the funding will cease before the litigation can be completed. If that happens the first defendant would be exposed to an insolvency risk. Secondly, thought has to be given as to how ultimately the litigation costs are to be financed. The first claimant expects to recover his outlay from the first defendant. However, the sums the first defendant may be able to recover as a result of the litigation are limited. Most of the members have ceased to be members by the passage of time and whilst the court-sanctioned questionnaire suggests about 700 members have sought to renew their membership of the first defendant there is no evidence that suggests other former members will rejoin. It must be questionable whether the first defendant could be viable in those circumstances with such a reduced membership, or whether that sort of membership size would in fact result, once it was understood that a substantial amount of resource would go to fund the debt due to the first claimant as a result of the litigation. Whilst it is not possible to be sure, it would appear realistic to assume that each party to the contemplated litigation would incur legal costs of about £350,000. That at least is the effect of the evidence filed on behalf of the defendants. Up to about £70,000 of that may be irrecoverable by the successful party even if the claim succeeds. If the claim were to fail, then the position would be bleaker. If it failed entirely the first defendant would be exposed a cost claim it has no realistic prospect of meeting. Some of the claims are stronger than others though none of the claims can be said to be more than realistically arguable. Costs are awarded in litigation of this sort usually adopting an issue based approach. There is a prospect therefore that if the first defendant succeeded on some claims but not on others, overall its cost recovery would be significantly reduced. Again this would expose the first defendant to the risk of insolvency, or at best substantial debt owed to the first claimant.
40. In those circumstances I return to the question identified in Section 263(2)(a). In my judgment a hypothetical director would not seek to continue the claim that is contemplated in summary because:
- (a) there is one claim based on the quoracy issue which is realistically arguable as against the second to fifth defendants;
  - (b) the claim against the sixth defendant is speculative because it is far from clear that even if the breach of fiduciary duties alleged as against the second to fifth defendants are established, the first defendant will be able to show a sufficient level of knowledge attributable to the sixth defendant to enable the claim against the sixth defendant to succeed;
  - (c) the value of the claim is modest in reality. It is not realistically arguable that it has a value of in excess of £5 million as alleged by the claimant on the material before me. At best the claim is for the return of £200,000 less any liabilities settled on behalf of the first defendant together with the tangible assets or alternatively their value;

- (d) the costs of the litigation are likely to be in the order of £350,000 per side. The first defendant can fund such expenditure only because of the goodwill of the first claimant and it is foreseeable that such funding will cease to be available for unforeseeable reasons before completion;
- (e) the first claimant will seek to recover his outlay from the first defendant;
- (f) on any view it is likely that up to 20 percent of the costs will be irrecoverable and thus will become a debt due from the first defendant to the first claimant;
- (g) if part of the claim is lost it is likely that only part of the first defendant's costs will be recoverable thereby increasing the first defendant's debt to the first claimant;
- (h) if the litigation is lost the first defendant will not have the means to pay;
- (i) although there is some evidence that about 700 members wish to rejoin the first defendant, it is unclear that will remain the case after a further year of litigation particularly if the first defendant were to emerge from the litigation with substantial debts incurred as a result;
- (j) it is not clear that the first defendant would be viable with 700 members and there is no logical reason to suppose that many more will return at any rate in the short term; and
- (k) the interests of the members can be provided for by the sixth defendant, which provides services at least equal to and arguably better and more extensive than those provided by the first defendant at a lower subscription which itself suggests that the ability of the first defendant to recover a viable mass of members in the short term would be limited.

41. Even if I was wrong in concluding that a hypothetical director would not seek to continue the claim I am entirely satisfied that it would nonetheless be wrong to give permission to bring this claim. I say that, first, for each of the reasons I have already identified and secondly for each of the further reasons identified below.

42. The strongest reason for permitting this litigation to continue are the views of the members as expressed in answer to the questionnaire administered pursuant to the order of Evans-Lombe J. I accept the claimant's submission that it would be wrong to speculate about the views of those who had not voted. However, of those that did vote a bare majority of 100 out of a total of just short of 1,700 who voted said they did not support the merger. However, that is to be viewed in context. The principle was strongly supported at the AGM on 4 April 2008 and was supported again when the question was canvassed in the first defendant's magazine. Proceedings to reverse the transaction were supported by a majority of only 44, which suggests that some of those who opposed the merger nonetheless opposed the litigation. The majority in favour of litigation against the second to fifth defendants was only 11. When it comes to the question of whether company funds should be used significantly fewer people voted on that question. Of the people who voted 411 did not answer the question. But, of those that did, over 200 supported the use of company funds for that purpose. Thus whilst the court is required to have regard to this material by Section 263(4), I am bound to say that I think the material provides limited support. However, it is support which the claimant is entitled to rely upon and which I take it into account in reaching my conclusion.

43. Section 263(3)(a) requires regard to be had as to whether the claimants are acting in good faith. As to this there are a number of considerations in my judgment that are

relevant. First, no attempt has been made by the claimants to show why the merger is not substantively in the best interests of the members. The evidence suggests that services equal to if not better than those provided by the first defendant were provided to all the first defendant's members after the merger had been completed and without additional charge. The subscription charged by the sixth defendant is lower than that which was charged by the first defendant. The absence of any explanation as to why the merger was not substantially beneficial to the membership suggests a lack of good faith as it is to be understood in this context.

44. There is a second factor which is relevant and that is the conduct of the first claimant. After it became clear to him that a majority of the Board supported merger with the sixth defendant, he had in my judgment two legitimate courses open to him. First it was open to him to attend Board meetings and argue his case and/or secondly to requisition an EGM (assuming he could raise the necessary support from amongst the members) and again seek to argue his case there, if necessary coupled with a resolution to replace the existing Board. He adopted neither of these courses. Instead he adopted a policy, in apparent combination with Mrs Kerslake, of absenting himself from Board meetings for the purpose of rendering them inquorate so that in consequence it became impossible to conduct the business of the first defendant. This was conduct which is strongly arguably a breach of fiduciary duty as imposed by Section 171 because he absented himself from Board meetings without permission and that cannot be acting in the best interests of the company in the way required by Section 172. The inference is that the first claimant adopted this course because he knew he could not succeed either before the Board or at an EGM. This inference is further supported by the fact that after attempting to requisition an EGM, which the Board could not order because it was inquorate, the first claimant did not proceed to convene the meeting as he was entitled to do. The reality is that the claimant wishes to bring the contemplated proceedings because he does not want to see the first defendant lose its identity or to lose control of it. Whether strictly this demonstrates a lack of good faith is not material – it is certainly relevant because Section 263(3) is not exhaustive of the matters that require to be considered and in my judgment motivation of this sort is a negative factor so far as this application for permission is concerned.
45. Section 263(3) requires consideration to be given to whether the matters complained of could be ratified. The truth is that because of the transient nature of the membership, many of those who were members in July 2008 will not be any longer and it is likely that those who have renewed or attempted to renew their membership of the first defendant are supporters of the first claimant. I suspect it is now unlikely that ratification can be obtained. In my judgment that factor is of limited consequence on the facts of this case. Finally, because Section 263(3) is not exhaustive of the matters that require to be considered, in my judgment the effect of what is proposed on former employees of the first defendant is something that I am entitled to take into account for the reasons already given.
46. There remains one final factor that is significant. Under the old law if there was no wrongdoer control of the company, permission would be refused for the obvious reason that in the circumstances there was no need for derivative proceedings to be commenced. It was submitted on behalf of the claimant that these principles do not appear in the statute and therefore are no longer relevant. I am doubtful if that is

correct. If the statute is followed strictly, the court is required to consider whether a prima facie case is established - see section 261(2). In considering that question, the court is bound to have regard, not merely to the factors identified in Sections 263(3) and (4), but to any other relevant consideration since Sections 263(3) and (4) are not exhaustive. It is open to the first claimant to requisition an EGM, obtain if he can a replacement Board and that Board can if it judges it appropriate to do so, applying the duties imposed upon them by Sections 172, authorise the litigation. This factor is at least a powerful one that negatives the giving of permission and may be overwhelming. However, I make clear that I have reached my conclusions for each of the reasons I have identified and that I would have reached the same decision irrespective of this last point.

47. In the result:

- (a) I conclude that a hypothetical director acting in accordance with Section 172 would not seek to continue these proceedings and by reason of that permission must therefore be refused applying Section 263(2); but
- (b) if I am wrong on that point I would nonetheless refuse permission.