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Shades of grey? Unfair prejudice and derivative actions in Jersey following Ntzegkoutanis v Kimionis

Introduction

Matters of law will certainly not always be black and white, however, the Courts have adopted a traditional approach when assessing matters of mismanagement or misconduct by directors in relation to company – if there is mismanagement of the affairs of a company, an aggrieved shareholder may pursue unfair prejudice relief. Where there has been misconduct, it is primarily for the company to claim in respect of it but a shareholder may apply for permission to pursue a derivative action on behalf of the company, if the company will not pursue the claim itself. This has certainly been the clear-cut case in Jersey. However, the English Court of Appeal delved into the various shades of grey when it handed down its judgment in Ntzegkoutanis v Kimionis and Another[1]. The Court of Appeal was called upon to assess when it is appropriate to pursue unfair prejudice relief and when a party ought to pursue a derivative action on behalf of the company.

The facts

Mr Ntzegkoutanis and Mr Kimionis were each a director of Coinomi Limited (the "**Company**") and each held shares in the Company. The Company was incorporated as a vehicle for a joint venture involving the exploitation of a cryptocurrency "wallet" application.

Mr Ntzegkoutanis complained that he was excluded from the management of the Company and that Mr Kimionis, his fellow director, had misappropriated the Company's business and assets. In doing so, Mr Ntzegkoutanis alleged that Mr Kimionis breached the duties that he owed to the Company as a director in procuring or permitting the transfer of the Company's business and assets to companies incorporated in Cyprus and the BVI.

Mr Ntzegkoutanis brought an unfair prejudice petition to the English High Court under the provisions of section 994 of the Companies Act 2006. Amongst other things he sought (i) orders that Mr Kimionis (together with the Cyprus and BVI companies) account and pay damages and/or compensation to the Company in respect of their gains and the Company's losses resulting from their conduct, and (ii) declarations that Mr Kimionis was a constructive trustee holding property on behalf of the Company.

The English High Court held that Mr Ntzegkoutanis was not permitted to apply for this relief in favour of the Company under the unfair prejudice provisions, but they ought to have been litigated against Mr Kimionis by way of a derivative claim instead. In reaching this conclusion, the High Court applied what it termed the "Chime approach" – an approach derived from the decision of the Hong Kong Court of Final Appeal in Re Chime Corp Ltd[2]. According to the Chime approach, it would only be a "rare and exceptional" case in which the court will permit an application for relief in favour of the company to proceed by way of a shareholder's unfair prejudice petition, when it could be brought by way of a derivative claim. When deciding what would constitute a sufficiently exceptional circumstance, the High Court was of the view that it must be satisfied, at a minimum, that the relief can be conveniently adjudicated on as part of the unfair prejudice proceedings. If not, the proceedings will be an abuse of process and ought not to be permitted to proceed. The English High Court accordingly struck out Mr Ntzegkoutanis' claim as an abuse of process.

The appeal

Mr Ntzegkoutanis appealed to the English Court of Appeal. He argued that the Chime approach does not form part of English law, and that, even concluding that it does, the High Court applied it wrongly. Mr Kimionis argued that the appeal should be dismissed but in the alternative, that the relief sought against the Company should be struck out, having regard to section 260(2) of the 2006 Act, such claims may only be brought with the permission of the Court or pursuant to an order to that effect.

The Court of Appeal concluded that:

1. The Chime approach does not form part of English law.
2. The Court does have the power to grant relief in favour of the company on an unfair prejudice petition.
3. The Court should not make an order in favour of the company on a shareholder's unfair prejudice petition unless that order corresponds with one to which the company would be entitled had the relevant allegation been successfully prosecuted by the company or by way of a derivative action in the name of the company.

1 (2004) 7 HKCFAR 546
2 [2023] EWCA Civ 1480

4. The intention of the petitioning shareholder is important – where the petitioner is not genuinely interested in obtaining such relief and is instead trying to bypass the filter provided for under the derivative action provisions, the proceedings can potentially be an abuse of process. The contrary rings equally true – where an unfair prejudice petition seeks both relief in favour of the company and relief that would not be available in a pure derivative claim, and the petitioner appears to be genuinely interested in obtaining the latter, it would not be appropriate to strike out the petition or any part of the relief sought. It would also not seem very convenient to insist that the claim for relief form part of a separate claim form.

5. Where in unfair prejudice proceedings, a petitioner asks for relief in favour of the company as well as relief that could only be granted on an unfair prejudice basis, the practical issue for the court is one of case management. It may be that the best course may for all the issues to be dealt with at the same time. Alternatively, it may also be desirable for the relief sought in favour of the company to be deferred either entirely or in part. It may also not be clear at the initial pleading stage that a determination of the quantum of the director's liability to the company can be conveniently dealt with within the hearing, rather than rendering the claim abusive.

The position in Jersey

What will the impact be on Jersey law? Currently, the leading authority is Prestigic (Wisely) Nominees Ltd v JTC and Others[3] in which the applicant, Prestigic, brought an unfair prejudice claim under Articles 141 to 143 of the Companies (Jersey) Law 1991 (the "**Companies Law**"). Specifically, Prestigic sought an order under Article 143 authorising it to bring proceedings against a third party in the name of the company as well as for an order for payment to the company of any such sums as found to be due and owing to the company. Prestigic's case was built on the allegations that the company had made payments to the third party and in authorising these payments, the directors had acted in breach of their fiduciary and statutory duties to the company to act in good faith in the best interests of the company.

Prestigic argued that the Royal Court had discretion to grant the relief sought under the provisions of Articles 141 and 143 of the Companies Law. Against that, the company argued that Prestigic ultimately sought relief for alleged past misconduct of the directors as opposed to the bringing to an end of the mismanagement of the company. Misconduct, it argued, is more appropriately dealt with by way of a common law derivative action.

In considering the claim, the Royal Court referred to and accepted a "developing body of case law", mainly English case law, but also including, in particular, Chime. In light of that case law, the Royal Court found that Prestigic's allegations were not of mismanagement, but simply of directors' misconduct, without more, which should be addressed by the remedy provided by law: an action by the company, or a derivative action in its name. Reaching this decision, the Royal Court noted that:

1. Prestigic conceded that its claim did not come within any of the exceptions to the rule in Foss v Harbottle that permit a derivative claim to be brought[4].
2. Prestigic accepted that the directors of the company were not improperly preventing the company from bringing proceedings against the third party.
3. It was not Prestigic's case that the directors had acted fraudulently in authorising the payments to the third party.
4. The payments complained of by Prestigic were ratified by shareholders' resolutions.

Notably, the Royal Court acknowledged that it had the jurisdiction to entertain Prestigic's application. However, it was of the view that an higher threshold must be met by Prestigic (and in doing so, borrowing from the words penned by Lord Scott in Chime) to show that the claim for the remedy in question is one that, as a matter of proper practice, the Court should grant.

Impact of Ntzegkoutanis on Jersey Law

In Prestigic the Royal Court adopted a firm line having considered and applied authorities reviewed (and ultimately rejected) in Ntzegkoutanis, including Chime. The question therefore arises – will the Royal Court continue follow or reject the Court of Appeal's approach?

Ntzegkoutanis appears to lower the bar for unfair prejudice claims. Its rejecting the Chime approach as part of English law meant that Ntzegkoutanis's was not struck out, but instead could proceed to be heard and decided in the usual way.

However, first, it simply decided that Ntzegkoutanis's claim should not automatically be struck out simply because it was a shareholder's unfair prejudice petition seeking relief in favour of the company. Instead, it held such orders might be sought in unfair prejudice claims.

Secondly, it does not follow that any such claim is more or less likely to succeed on its merits. Ntzegkoutanis did not increase the circumstances that might be pleaded as such a claim, but only that, in appropriate circumstances, such a claim can be pleaded.

Thirdly, when such a claim is pleaded Ntzegkoutanis still noted there will be case management issues for the court to consider, and principally whether the claim for relief in favour of the company should be heard at the same time as the claim for relief in favour of the shareholder, or whether one should be heard before the other. This reflects observations which the Court of Appeal in Ntzegkoutanis made in respect of an application of the Chime approach: if such claims could not be brought in the same claim as an unfair prejudice claim, they would risk being brought in parallel proceedings, which the court would then have to decide whether to hear together or separately anyway.

3 [2012] JRC 097
4 (1834) 2 Hare 46. The rule provides that where a wrong is done to a company, only the company may sue for any loss suffered as a result of the wrong and that an individual shareholder has no standing to sue. In order to qualify as an exception to this rule. An applicant needs to show that it falls within the "fraud on a minority" exception. This rule has been applied in Jersey on a number of occasions – see Khan v Leisure Enterprises [1997] JLR 313

So, Ntzegkoutanis can be seen more as an evolution of practice rather than revolution of law. Rather than the black and white Chime approach immediately striking out unfair prejudice claims seeking relief in favour of the company, under the Ntzegkoutanis approach they can proceed, but subject to practical considerations of case management.

Prestigic was decided in light of the "developing case law" at the time, of which Ntzegkoutanis can be seen to be a further development. Although Ntzegkoutanis means that there is now a difference in the developed case law between Chime in Hong Kong and Ntzegkoutanis in England, as the latest development is a more nuanced, than black and white approach it may be thought it will commend itself to the Royal Court.

Further information

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