ABSTRACT

The reform of the common law ‘derivative action’, by the statutory ‘derivative claim’ in Part 11 of the Companies Act 2006, was long overdue. Many of the common law’s most intractable problems, however, lay not with the derivative action itself, but rather with the law governing the ratification of breaches of duty. The source of many of these problems lay in the distinction the law sought to draw between fraudulent and non-fraudulent breaches, and the different consequences attached to each category of wrongdoing. The Companies Act 2006 was a timely opportunity at least to resolve the confusion within the law, and ideally to adopt what has been termed a ‘voting based’ approach to ratification. Sadly, the Act did neither, preferring instead to retain the common law largely untouched. Moreover, as a careful analysis of the Act itself shows, the modest changes it did introduce necessarily preserve the common law’s distinction between fraud and non-fraud, and the uncertainty to which this gives rise. The article concludes with an examination of Franbar Holdings v Patel, which illustrates clearly the shortcomings in the law’s limited reforms.

I: INTRODUCTION

The common law derivative action had few friends. The Law Commission, in its Report on shareholder remedies, spoke of a set of rules that lacked clarity, was unduly complex, and

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suffered from inaccessibility, being found only in case law stretching back over very many years. The solution to these fundamental defects was to be the wholesale replacement of the common law action by a new statutory ‘derivative claim’, with the relevant rules displayed clearly within the statute rather than buried in the case law.

Yet the project of reforming the derivative action was always a limited one. Both the Law Commission, and ultimately the Companies Act 2006 (hereafter ‘the Act’) which introduced the statutory derivative claim, left almost wholly untouched the rules on the ratification of directors’ breaches of duty, notwithstanding that much of the uncertainty and inaccessibility surrounding derivative claims arose precisely from those rules. To be sure, the desire of law reformers to keep their projects within manageable limits is understandable. However, as the Law Commission itself conceded, it risks allowing the doubts and defects of the old law to creep back into the new, destroying the certainty and accessibility that was the very purpose of reform, like failing to remove all the infectious material from a wound.

Many of the common law’s problems stem from its devotion to what has been called a ‘transaction based’ approach to ratification, in which much (though it has never been clear how much) depended upon the character of the original wrongdoing, and in particular whether it

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2 See Law Commission, Shareholders' Remedies (Law Commission Report No 246, Cm 3769, Stationery Office, 1997) para. 6.4
4 On the ‘accessibility agenda’ within the Act, see D Ahern, ‘Directors' duties, dry ink and the accessibility agenda’ (2012) Law Quarterly Review 114.
amounted to a ‘fraudulent’ wrong. The Act offered a missed opportunity to abandon this approach, and to switch the law’s focus instead to the process of ratification. All breaches of duty, it will be argued, should be capable of being ratified, but all ratifications should require the same rigorous process – in terms of the independence, the disinterestedness and the knowledge of those permitted to take part in the decision to ratify. The normative arguments in favour of this so-called ‘voting based’ approach are compelling. It promises both greater certainty (avoiding the nebulous distinctions between different categories of wrongdoing drawn by the transaction based approach) and greater fairness (by precluding wrongdoers from sanctioning their own misbehaviour, whilst preserving the operation of majority rule amongst non-wrongdoers).

The structure of the article is as follows. Part II describes the common law position on ratification and ratifiability, identifying the obscurity surrounding the definition of fraudulent misconduct and the uncertainty regarding the consequences for a wrong being categorised as such. Part III considers the defects in the law’s regulation of first non-fraudulent, and then fraudulent, wrongs, and the comparative merits of the voting based approach. Part IV turns to the Act. It concedes that it introduced some welcome improvements in the law governing derivative claims, not least in its abandonment of the concept of ‘fraudulent wrongs’ as the precondition for bringing derivative proceedings. But, as Part IV shows, the Act immediately reintroduces this concept, with all its associated uncertainty and unfairness, through its retention of the common law rules on ratification and the transaction based approach which those rules entail. Nor, it will be argued, can these problems be solved by adopting what has been termed a ‘heretical’ interpretation of the common law. For such a strategy flounders on an apparently quite minor technical amendment Parliament introduced, during the passage of the Act, to an otherwise laudable change to the voting process for ratifying breaches of duty. The problem is
starkly illustrated by the case of Franbar Holdings Ltd v Patel,\(^8\) to which Part V turns. Part VI concludes.

**II RATIFICATION AT COMMON LAW**

We should begin by distinguishing two different senses in which ‘ratification’ might be used in the corporate context.\(^9\) One – ‘internal’ – sense entails the purported release of a director’s liability to the company for her breach of duty. The other – ‘external’ – sense concerns the validation of transactions entered into by the company with a third party. A director’s misconduct, such as exceeding her authority when negotiating a contract with a third party, might threaten the validity of that contract. But the company might choose to ratify the transaction, meaning to validate it, and thus ensure that the contract is enforceable. This article is concerned only with the first sense of ratification – as release. Note also that ratification, as ‘release’, is closely related to, but needs to be distinguished from, ‘authorisation’. The distinction is based on timing. Ratification refers to a release given once a breach has already occurred; authorisation entails shareholders approving a director’s future conduct, to prevent a breach occurring in the first place.\(^10\) (Although authorisation is certainly relevant to our discussion, we shall refer only to ratification in this Part, assuming that the rules described as applying to ratification apply also to authorisation.)

At common law, effective ratification was fatal to a derivative action, but it is again worthwhile distinguishing two reasons why it might be so. First, if ratification releases a director

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\(^8\) [2008] BCC 885.


from her breach of duty, then there ceases to be any wrong for which the company itself could sue, and therefore any wrong for which any shareholder could sue derivatively on the company’s behalf. 11 Indeed, if the company is bound, ratification will effectively be irrevocable, preventing the board, the members, 12 or a subsequently appointed liquidator, from deciding the company should sue. In fact, it has been questioned whether ratification alone does indeed bind the company, or whether the director must also supply some consideration 13 to the company for such a release to be binding. 14 The more widely held view seems to be that ratification alone suffices. 15 However, whether or not the company is itself bound, there is a second reason why ratification was fatal to derivative proceedings, a reason based on the principle of majority rule. If the majority voted to ratify, then minority shareholders at least were bound by that decision, and could not then attempt to sue derivatively. 16

Not all wrongs, however, were ratifiable. In Edwards v Halliwell, 17 in what has become the classic modern statement on the point, Jenkins LJ noted four categories of misconduct 18

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11 A shareholder’s right to sue derivatively, on the company’s behalf, can be no greater than the company’s right to sue for itself: Burland v Earle [1902] AC 83, p.93.
12 Both current, and future, members would be so prevented.
13 Or point to a release given under seal by the company.
16 Indeed, at common law the mere ratifiability of the misconduct (regardless of whether it had in fact been ratified) was seen as justifying the denial of a derivative suit, for there was no point in permitting an action by an individual shareholder when the majority could, and presumably would, decide whether to sue or to ratify. 17 [1950] 2 All ER 1064. For a more detailed discussion of these four categories of unratifiable wrong, see (the 2-part article by) K.W.Wedderburn, ‘Shareholders’ Rights and the Rule in Foss v. Harbottle’ (1957) Camb L J 194 and (1958) Camb L J 93.
18 These were ultra vires and illegal acts, acts requiring the sanction of a special majority, acts infringing the personal rights of shareholders, and acts which constitute a fraud on the minority. The suggestion of a fifth
which were beyond the power of a bare majority to condone. Only the fourth category – breaches of duty amounting to ‘fraud on the minority’ – concerns us here. Such breaches were incapable of ratification by a simple majority. Notwithstanding any purported ratification, a member would remain free to bring a derivative action on the company’s behalf in respect of such a breach (provided that she could also establish that the wrongdoers were in control of the company and preventing it from suing).\footnote{Burland v Earle op cit n11.} Yet beyond this trite observation, almost everything else about this category of ‘fraud on the minority’ was fraught with confusion.

\textit{Fraud: its meaning and consequences}

Much of the uncertainty flowed from the fact that the common law adopted what has been called a ‘transaction based approach’.ootnote{See H.C.Hirt, ‘Ratification of breaches of directors’ duties: the implications of the reform proposal regarding the availability of derivative actions’ (2004) \textit{The Company Lawyer} 197; A.Keay and J.Loughrey, ‘Derivative proceedings in a brave new world for company management and shareholders’ [2010] \textit{J.of Bus.Law} 151, pp.162-5; J.Payne, op cit n9, pp.611-3.} It did so in the following sense. The validity of any ratification of a breach of duty depended upon whether that breach was to be categorised as ‘fraud’, and that, in turn, depended upon its inherent character.\footnote{See K.W.Wedderburn, op cit n17.} Yet the ‘inherent character’ that resulted in a breach being categorised as fraud, as well as the precise consequences, so far as ratification was concerned, that flowed from a breach being so categorised, remained opaque.

As to the latter point, whilst it was reasonably clear that breaches of duty that were categorised as non-fraudulent were ratifiable, and indeed that the wrongdoing director was entitled herself to vote as a shareholder in favour of their ratification,\footnote{This applied the general principle that members of a company were permitted to vote, as shareholders, on matters in which they were interested; see eg \textit{North-West Transportation v Beatty} (1887) 12 App.Cas.589.} considerable doubt

\begin{itemize}
\item \textit{Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] 1Ch 204.}
\item \textit{Barland v Earle op cit n11.}
\item \textit{See K.W.Wedderburn, op cit n17.}
\end{itemize}
surrounded the status of breaches that did amount to fraud. The orthodox view was that fraud was simply unratifiable, and that remained the case whatever the process by which any purported ratification took place.23 This reinforced the point that fraud was simply a matter of the character of the wrongdoing, and had nothing to do with the process of ratification. As Wedderburn put it, ‘[f]raud lies rather in the nature of the transaction than in the motives of the majority’.24 The alternative – but heretical – position was that even wrongs that constituted fraud could be ratified but, in contrast to non-fraudulent wrongs, the process of ratification was required to be more rigorous and, in particular, had to be effected in some sense ‘independently’ of the wrongdoers. We return to this below.

For now, we turn to the law’s failure to identify clearly what characteristics made a wrong sufficiently egregious to constitute ‘fraud’ in the first place. This failure has been well rehearsed elsewhere, and need not be explored in detail here.25 As one writer put it, the category of fraud ‘comprises a ragbag of miscellaneous fiddlings which seem to defy all attempts to form them into recognisable juridical classes.’26 Misappropriating corporate property was seen as the clearest example of fraud,27 but to cast the net of liability more widely ‘property’ came to be given an extended, and consequently more nebulous, meaning.

In Burland v Earle, for example, property was said to include ‘money, property or

24 K.W.Wedderburn, ‘Shareholders’ Rights and the Rule in Foss v. Harbottle’ (Part 2) (1958) Camb L J 93, p96. It was in this sense that Lord Wedderburn thought the fourth exception to Foss ought to be called ‘fraud on the company’ than ‘fraud on the minority’.
26 C.R.Baxter, ibid, p14.
27 See Burland v Earle op cit n11, p.93.
advantages which belong to the company or in which the other shareholders are entitled to participate.\footnote{28} And in \textit{Cook v Deeks}, it was extended to property ‘which belongs in equity to the company’, namely a mere corporate opportunity grabbed by the directors personally.\footnote{29}

However, basing fraud upon this capacious conceptualisation of corporate property proved hugely difficult to reconcile with the House of Lords’ decision in \textit{Regal (Hastings) Ltd v Gulliver}.\footnote{30} The directors of Regal exploited for their own benefit an opportunity originally available to their company.\footnote{31} Nevertheless, the court indicated that ratification would have been possible meaning, according to the orthodox understanding, that their misconduct did not amount to fraud.\footnote{32} To be sure, there may have been differences in the character of the wrongdoing in \textit{Regal}, compared to that in, say, \textit{Cook}, such as whether the directors’ were acting in good faith,\footnote{33} or whether the company was ultimately harmed or helped by the directors’ behaviour.\footnote{34} Yet those differences do not seem to turn on whether property, in its extended sense, was taken, but instead simply bring in additional factors to excuse this misappropriation of a broadly-conceived ‘property’.

The transaction based approach also struggled in its treatment of negligence. Negligence would not appear to constitute a misappropriation of property, and indeed was held to be ratifiable in \textit{Pavlides v Jensen}.\footnote{35} Yet in \textit{Daniels v Daniels},\footnote{36} the court extended fraud to capture

\footnote{28} \textit{Ibid}.
\footnote{29} [1916] 1 AC 554, pp.563-4. For difficulties in construing \textit{Cook v Deeks} as involving a taking of corporate property, see Sullivan \textit{op cit} n25, 241.
\footnote{30} [1967] 2 AC 134.
\footnote{31} \textit{Ibid}, p.143.
\footnote{32} In fact, the directors failed to take the precaution of having their conduct ratified, notwithstanding the impending sale of the company to a third party, who subsequently caused the company to sue the (by now former) directors.
\footnote{34} See eg B.Hannigan, \textit{op cit} n23, p.506.
\footnote{35} [1956] Ch 565.
\footnote{36} [1978] Ch 406.
what has been termed ‘self-serving’ negligence, with Templeman J declaring that fraud exists where directors ‘use their powers, intentionally or unintentionally, fraudulently or negligently, in a manner which benefits themselves at the expense of the company.’ Once again, the difficulty was reconciling this even-broader conceptualisation of fraud with Regal, in which the directors clearly did benefit themselves. A possible reconciliation is available through Templeman J’s rider that the self-benefit must be ‘at the expense of the company’. If it really would not be in a company’s best interests to exploit an opportunity which a director then takes for herself, arguably the company loses nothing as a result. Yet this requires a judicial business judgement whether it would have been in the company’s own interests to exploit the commercial opportunity for itself, something courts have steadfastly refused to do.37

If the meaning of fraud was shrouded in uncertainty, so too were its consequences. As noted, the orthodox understanding held that fraudulent wrongs were simply unratifiable. The alternative, heretical, view was that such wrongs were not inherently incapable of being ratified. Rather, their fraudulent character merely prevented the wrongdoers from procuring their release. The most familiar recent judicial expression of this view was by Vinelott J at first instance in Prudential Assurance Co Ltd v Newman Industries Ltd (No 2).38 Starting with the definition of fraud itself, Vinelott J interpreted earlier case law as holding fraud to exist whenever the wrongdoer obtained a personal benefit.39 This was clearly similar to the definition adopted by Templeman J in Daniels, although with no requirement that the benefit

37 In Regal itself, op cit n30, Lord Russell of Killowen, emphasised that liability applied irrespective of ‘whether the plaintiff [company] has in fact been damaged or benefited by his action’ (p144) and Lord Wright (p154) noted the court’s inability to determine whether the company was commercially able to exploit for itself the opportunity taken by the director.
38 [1981] 1Ch 257.
39 Ibid, 316
be made ‘at the expense of the company’. However, *Regal* then presented an even greater challenge to this approach, for on this definition the directors were indisputably guilty of fraud, and the possible absence of any harm to the company could not now be invoked to avoid this conclusion. But Vinelott J turned this difficulty to his advantage, arguing that *Regal* demonstrated that even fraudulent wrongdoing was capable of ratification, provided that the wrongdoers ‘did not control the company’ and that the majority ‘does not have an interest which conflicts with that of the company’. It was in this sense, Vinelott J argued, that the House of Lords in *Regal* had suggested the directors could have had their misconduct ratified.

It is worth pausing here to stress that Vinelott J continued to adopt a transaction based approach, in the sense described above. Fraudulent and non-fraudulent breaches were still to be distinguished, and treated differently. Only the former required a disinterested vote to be ratified; non-fraudulent wrongdoing, Vinelott J felt bound to accept on the basis of past precedent, could still be ratified with the votes of wrongdoers.

The additional uncertainty generated by this heretical, and competing, account of the law might be avoided if one could easily dismiss Vinelott J’s efforts as an obvious misreading of the doctrine. Yet whilst some have certainly sought to do so, other commentators have countered that the heresy enjoys rather more, and the orthodoxy rather less, precedential support than is too often assumed. So, whilst Wedderburn described

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40 *Ibid*, 316 D. As Vinelott J himself conceded (316F), a test of ‘personal benefit’ created a penumbra of uncertainty where the benefit was received not by the director personally but, say, by a member of his family.
42 See supra n20 and the text therewith.
43 Of course, Vinelott J’s broadened definition of fraud, requiring only personal benefit by the wrongdoer, would correspondingly reduce the instances of non-fraudulent breaches of duty.
45 See eg Baxter *op cit* n25 and Sullivan *op cit* n25.
Vinelott J’s re-reading of *Regal* as ‘ingenious but astonishing’, Sullivan noted that comments in *Regal* about the possibility of ratification were clearly *obiter*, and that accordingly ‘*Regal* has nothing to say on the prerequisites of valid ratification. It neither confirms nor denies the Vinelott analysis’. Similarly, although Vinelott J’s judgement was badly mauled by the Court of Appeal, the Court’s comments regarding the preconditions for a derivative action were, strictly, *obiter*.

Adding to the uncertainty is the fact that in many of the cases where the courts refused to respect a purported ratification, such as *Cook v Deeks*, or *Atwool v Merryweather*, the wrongdoers typically *did* have control of the company and used it to ratify their own wrongdoing. It is, then, unclear whether the ratification was ineffective because of the category of the wrongdoing (as the orthodoxy argues), or because of the self-serving use of the wrongdoers’ votes (as the heretical interpretation claims). As Baxter put it, bluntly, ‘[w]here was it held, that is to say, necessarily held as a matter of black letter *ratio deciden
di,*

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46 Wedderburn, *op cit* n33, pp.210-211. Wedderburn pointed out that the House of Lords said nothing to suggest the directors would not have been permitted to vote on the ratification, and doubted they intended this but simply forgot to mention it.

47 Sullivan, *op cit* n25, p.248.


49 By the time of the Court of Appeal hearing, the company’s board had decided to adopt the proceedings, thus rendering unnecessary the derivative proceedings.

50 *op cit* n29.

51 (1867-68) L.R. 5 Eq. 464

52 See, for example, the ambiguity inherent in Jessel MR’s explanation of *Atwool v Merryweather* (in *Russell v Wakefield Waterworks Co* (1875) LR 20 eq 474 at 482), where he notes, ‘[i]t was said that justice required that the majority of the corporators should not appropriate to themselves the property of the minority, and then use their own votes at the general meeting of the corporation to prevent their being sued by the corporation’.
that if a fraud is practised on a company by its controllers all its shareholders are thereupon barred from exercising any judgement on the matter?\textsuperscript{53}

Since the cases do not show unequivocally that it is the character of the wrongdoing that precludes ratification, those defending the orthodoxy have tended to fall back on more indirect doctrinal points in support. But these hardly provide knock-down arguments either.\textsuperscript{54} Wedderburn, for example, argued that permitting ratification by independent shareholders would require the court to do ‘what a century ago James L.J. [in Mason v. Harris (1879) 11 Ch.D. 97, 109] concluded English courts could not do: submit the issue to a meeting at which only independent or "disinterested" shareholders may vote’.\textsuperscript{55} Yet even if the court cannot order such a meeting to be held, this hardly settles the effect of a ratification passed at a meeting which the company has chosen to hold. Moreover, the Court of Appeal itself in Prudential, when considering how a judge was to determine whether a derivative action should be allowed to proceed, accepted it might be appropriate for the judge ‘to grant a sufficient adjournment to enable a meeting of shareholders to be convened by the board, so that he can reach a conclusion in the light of the conduct of, and proceedings at, that meeting’.\textsuperscript{56} Finally, in Smith v. Croft (No 3),\textsuperscript{57} the court held that an independent organ of the company (such as a meeting of shareholders all of whom were independent of the wrongdoer)\textsuperscript{58} might decide that the company should not sue, and such a decision would be

\textsuperscript{53} Baxter, \emph{op cit} n25, p15.

\textsuperscript{54} In this Part, we are considering only the doctrinal support for the orthodox, and heretical, versions of the transaction based approach. Part II addresses the policy arguments in their support.

\textsuperscript{55} R J Wedderburn, \emph{op cit} n33, p.208, fn. omitted.

\textsuperscript{56} \emph{Op cit} n18 at 222A.

\textsuperscript{57} (1987) 3 BCC 218.

\textsuperscript{58} It has been argued that a sufficiently independent board of directors might also constitute such an organ; see D.D.Prenctice, ‘Shareholder Actions: the Rule in Foss v Harbottle’ (1988) 104 LQR 341, pp.345-6.
binding upon a minority shareholder, even if the wrong was unratifiable.\textsuperscript{59} Although a decision not to sue would not, technically, constitute a ratification, and thus would not be binding on the company itself,\textsuperscript{60} it suggests nevertheless a \textit{procedural flexibility} at odds with the court’s view in \textit{Mason v Harris}.\textsuperscript{61}

Wedderburn also claimed that permitting wrongs categorised as fraud to be ratified, provided this were effected without the votes of the wrongdoers, conflicted with past decisions holding that shareholders were entitled to vote on a matter notwithstanding they had a personal interest in it.\textsuperscript{62} This might indeed have been a compelling argument against any \textit{judicial}\textsuperscript{63} attempt to prevent interested members from voting in respect of non-fraudulent wrongs. However, as we have seen, Vinelott J accepted that some wrongs would remain categorised as non-fraudulent, and that wrongdoers would remain entitled to vote to ratify them. He sought to ignore the votes of wrongdoers only in respect of misconduct categorised as fraud. Yet in respect of such wrongs, the orthodoxy viewed \textit{all} shareholders as having no right to vote in favour of ratification.\textsuperscript{64} And as noted, in \textit{Smith v Croft (No3)}, it was accepted that the votes of wrongdoers might be ignored (albeit this was held in respect of a decision not to sue rather than to ratify).\textsuperscript{65}

\textsuperscript{59} The decision in \textit{Smith v Croft (No3)} applied Vinelott J’s earlier judgement in \textit{Taylor v. National Union of Mineworkers (Derbyshire Area)} [1985] BCLC 237.

\textsuperscript{60} The case does assume that ratification is binding on the company although, as we noted above (\textit{supra} n14 and the text therewith this is not entirely certain).

\textsuperscript{61} See text with n55 \textit{supra}.

\textsuperscript{62} See \textit{supra} n33.

\textsuperscript{63} But not, to be sure, of any legislative reform of the law, as occurred by Companies Act 2006 s239(3)-(4); see \textit{infra} Part IV.

\textsuperscript{64} See Baxter, \textit{op cit} n 25, p.16.

\textsuperscript{65} Or, to put the point more strictly, the validity of a decision not to sue would depend upon whether wrongdoers had voted.
Let us recap. The common law governing ratification exhibited all the complexity, inaccessibility and lack of clarity which the Law Commission so forcefully condemned. The whole edifice of the transaction based approach was built around a distinction between fraudulent and non-fraudulent wrongs, yet it was fundamentally uncertain which breaches of duty fell into either category. The distinctions between them turned on nebulous concepts, such as the misappropriation of property, or else on factors which were likely to prove difficult to apply in practice (such as whether the wrongdoer had received a personal benefit) or which the law had wisely chosen sometimes to exclude in its formulation of the substantive content of some directors’ duties (such as whether the company had been harmed by the director’s wrongdoing). Nor could one say with certainty what were the consequences of a wrong being categorised as fraud. Fundamental disagreement existed between the orthodox and heretical interpretations of the transaction based approach, and neither position could be easily dismissed as simply not fitting with relevant case law.

III: THE BAD CONSEQUENCES OF A CONFUSED DISTINCTION

The preceding Part focused on the law’s lack of clarity and certainty. These are undoubtedly significant defects. Yet the problems run deeper still. This Part, accordingly, turns to examine the underlying policy considerations which render the common law treatment of ratification so unsatisfactory. As we have seen, the common law’s transaction based approach attempts to distinguish between fraudulent and non-fraudulent breaches of duty in order to fashion different treatments for each category of wrong. Yet, it will be argued, neither such treatment can be justified.

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66 See for example the imposition of liability under the no-profit rule.
(a) The treatment of non-fraudulent wrongs

The first criticism concerns the law’s lax treatment of wrongs categorised as non-fraudulent. There were two aspects to this. First, mere ratifiability, rather than actual ratification, was sufficient to prevent any derivative action in respect of such a wrong. The law could safely assume that members would be happy to ratify the wrong (even if they had not bothered to do so) for if they were not happy to ratify, they would presumably take steps to have the company sue instead. But such an assumption is quite unrealistic. There may be many reasons why a majority of members that does not wish to ratify still does not take on the significant burden of suing. One reason is that companies’ constitutions typically no longer give a simple majority of shareholders authority to determine that proceedings shall be brought. To be sure, shareholders might be able, by special resolution, to direct the board to commence proceedings. But this requirement of a special resolution to force the issue destroys the neat symmetry behind the assumption that if a bare majority of members does not favour ratification, that bare majority could instead cause the company to sue.

Second, wrongs which did not amount to fraud could be excused by a resolution passed with the votes of the wrongdoers themselves. Yet there was nothing inherent in the nature of non-fraudulent wrongs to warrant such self-interested release. As Worthington has noted,

67 See eg Edwards v Halliwell op cit n17, p.1066.
69 That shareholders’ authority to sue depends upon their company’s constitution, rather than company law, seems to be confirmed by Breckland Group Holdings v London and Suffolk Properties [1989] BCLC 100; V.Joffe, D.Drake, G.Richardson and D.Lightman, Minority Shareholders: Law, Practice, and Procedure (Oxford: OUP, 2008, 3rd Ed) paras 1.05-1.08.
70 See for example reg.3 of each of the three current versions of Model Articles (for Private Companies Limited by Shares, for Private Companies Limited by Guarantee, and for Public Companies) found respectively in Schedules 1-3 of The (Companies (Model Articles) Regulations 2008 SI 2008/3229).
71 Ibid, reg.4 gives shareholders this power.
whatever the character of the underlying wrong to the company, a decision to ratify may involve giving up a valuable corporate right. Whilst it might be acceptable for a majority of shareholders to release a director from liability, that director (and others too close to her) should not be permitted to participate in such a decision. It might be thought this second criticism is so widely accepted that there is little point in labouring it. Indeed, as we shall see, under the Companies Act 2006 wrongdoers’ votes must now be ignored on any ratification. And yet, this statutory restriction is limited, both in terms of those whose votes cannot be counted, and in the fact that the restriction applies only to ratifications, and not to prior authorisations at all. Moreover, disenfranchising members from voting has raised disquiet from some commentators, and there are at least two counter-arguments that might be offered against denying wrongdoers the right to vote which deserve to be considered further.

First, ignoring wrongdoers’ votes might be seen as an unjustifiable infringement of shareholders’ property rights, as owners of the company. It would be easy to dismiss this counter-argument by noting that to assume shareholders are indeed ‘owners’ of the company, and that their rights can be deduced straightforwardly from that ownership, gets matters the wrong way round. We need first to decide what rights shareholders ought to enjoy, and then decide whether those rights would justify us in describing shareholders as ‘owners’. Yet this still leaves open the question of what rights – and, in particular, what voting rights – shareholders

\[72\] S.Worthington _op cit_ n15.

\[73\] See _infra_ Part IV.

\[74\] Ibid.

\[75\] See for example L.S.Sealy, _op cit_ n48 and Baxter, _op cit_ n25.

\[76\] This is often taken to be the justification for _dicta_, such as in _North-West Transportation v Beatty, op cit_ n23, permitting shareholders to vote notwithstanding a personal interest in the matter; see eg J.E.Parkinson, _Corporate Power and Responsibility_ (Oxford: OUP, 1993) 255. Of course, a shareholder’s right to vote out of self-interest is not entirely unlimited. Most notably, a resolution by members to alter a company’s articles is liable to be set aside if not passed ‘bona fide in the best interests of the company as a whole’: see _Allen v Gold Reefs of West Africa Limited_ [1900] 1 Ch 656.
should have. One way to determine that is to think what voting rights shareholders would, at the outset of their relationship, rationally agree upon. Would shareholders, unaware of whether they will in the future be wrongdoers or non-wrongdoers, prefer a regime under which wrongdoers are permitted to vote to excuse their own wrongdoing?

To apply this ‘contractarian’ method of identifying shareholders’ rights, it would seem plausible to imagine that shareholders participate in the co-operative enterprise that is a corporation primarily in order to secure their own self-interest. But is a member’s self-interest better served by permitting, or by precluding, herself and her fellow shareholders from voting where personal interests conflict with the commercial interests of the company? The answer, surely, is that it all depends. On the one hand, if members with such conflicting personal interests are prevented from voting, then this is likely to advance the value of the company, and in so doing to maximise average shareholder wealth. This would seem to support disenfranchisement. And yet shareholders, surely, would also foresee, ex ante, that they may have some legitimate personal interests they wish to be able to assert even if this lowers the company’s value. Shareholders sometimes – and especially in quasi partnerships – have expectations to remain directors, to see a certain dividend policy respected, certain possible lines of business foregone, and so on, even if this will decrease the company’s value. Of course, there are many ways in which shareholders may seek to protect such interests, of which retaining the

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77 Literature discussing and debating the merits of contractarian analysis in company law is too voluminous to cite, but a useful introduction remains B.R.Cheffins, Company Law: Theory, Structure and Operation (Oxford: OUP 1997). Where, as here, such analysis employs the parties’ ‘hypothetical bargains’ to prescribe the content of company law (rather than, say, seeking to describe and explain the current content of company law) it draws on a larger literature exploring the design of ‘default rules’ in contract law more generally. On that, see for example D.Charny, ‘Hypothetical Bargains: The Normative Structure of Contract Interpretation’ (1991) 89 Michigan L.Rev.1815; C.A.Riley, ‘Designing Default Rules in Contract Law: Consent, Conventionalism and Efficiency’ (2000) 20 OJLS 367.

78 Options would include the creation of constitutional rights, class rights, rights conferred by shareholder agreements, and so forth.
right to vote self-interestedly is probably not the most effective. The point here is only that permitting self-interested voting in respect of such matters may be rational for shareholders to agree *ex ante*.

Is, however, the right to vote to excuse one’s own breach of duty the sort of interest which shareholders would agree each might legitimately assert? Surely it is not. It seems entirely implausible to think that any member would argue, *ex ante*, that she has an important interest, integral to her membership of the company, in permitting herself to excuse her own future breach of duty. On the contrary, the behaviour expected of a director is itself specified *ex ante*. The duties to which they are subject can be regarded as a set of rules designed to maximise the value of the company,⁷⁹ and thereby the collective wealth of all members. To allow an individual member to vote, out of self-interest, to excuse her own breach of those duties, frustrates this prior planning.⁸⁰ And, to labour the point, this is so in respect of all those duties, whether they involve negligence, personal benefit, misappropriation of property, and so on. Of course, if the purpose of the duties is indeed to maximise the value of the company, then whether a breach of duty should, *ex post*, in a particular case, be released or enforced will depend upon whether its enforcement will indeed maximise the value of the company. But again, this is a matter that should be determined solely by calculation of what is in the company’s interests,⁸¹ without being influenced by the illegitimate interests of any particular member.

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⁷⁹ It would require a much longer work to determine whether this condition is currently met in the UK. But if not, it would seem to require an adjustment of the duties of directors, not a rejection of the argument being advanced here.

⁸⁰ Companies Act 2006, s 232 (provisions protecting directors from liability are void) might be argued to rest on the assumption that shareholders would not rationally seek to exclude *ex ante* the duties imposed on directors.

⁸¹ This is, surely, the approach captured by the ‘hypothetical director’ test which courts must apply, under Companies Act 2006, ss 263(2)(a) and 263(3)(b), in deciding whether to grant permission to continue a derivative claim. For factors the courts have identified as relevant to this commercial calculation, see eg *Franbar Holdings v Patel op cit* n8 and *Iesini v Westrip Holdings Ltd Ltd* [2010] BCC 420.
The second counter-argument (against disenfranchising wrongdoers) is based on the claim that the company’s commercial interests might in fact be promoted if enforcement action against directors for non-fraudulent wrongs – and especially for negligence – were inhibited. Actions for negligence may risk requiring judicial business judgements for which judges are ill-equipped, threaten to waste managerial time and effort, and may encourage an excessively risk-averse attitude by directors who worry whether their reasonable mistakes will be judged too harshly by courts enjoying the luxury of hindsight. Permitting ratification by wrongdoers reduces the likelihood of actions and thereby reduces the foregoing problems.

In response to this argument, it might be suggested that a better way to reduce the threat of liability for negligence is by changing the content of the duty itself, reducing the standard of conduct demanded of directors. Better to demand a lower standard that is effectively enforced than to impose a higher standard with little prospect of enforcement. However, Eisenberg has argued that there may in fact be good reasons for maintaining a comparatively high standard of conduct, achieved by an onerous legal duty of care and skill, even whilst ensuring that this high standard of conduct is not effectively enforced by the courts. Eisenberg’s essential point is that a demanding duty of care might generate improvements in the behaviour of those on whom the

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83 A Reisberg, *op cit* n1, pp48-50
84 This is the so-called ‘hindsight bias’ – that the bad consequences of a decision are taken to mean that the decision itself was a bad one.
85 For an argument to that effect, see C.A.Riley, ‘The Director’s Duty of Care and Skill: The Case for an Onerous but Subjective Standard’ (1999) *MLR* 697.
86 The enforcement (as opposed to the substantive content) of directors’ duties has recently begun to receive increased attention; see for example J.Armour, ‘Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment’; in J Armour and J Payne (eds), *Rationality in Company Law* (Oxford: Hart Publishing 2009).
duty is imposed (say through *social norms* that encourage compliance), notwithstanding that legal enforcement of the duty is deliberately made unlikely.

Nevertheless, even if Eisenberg’s argument is accepted, it is unconvincing to suggest that the common law’s lax attitude towards ratification is the appropriate way to inhibit actions for negligence. Eisenberg himself argues that the appropriate safeguard against directors facing excessive liability is the courts’ ‘standard of *review*’ – the standard the court applies when it decides whether to impose liability for breach of the law’s demanding duty of care. By setting this standard of *review* relatively low – primarily through the business judgement rule\(^88\) – courts can retain a demanding duty of care, yet ensure directors are rarely actually held liable for breaching it. In comparison, inhibiting the number of legal actions for negligence by permitting self-interested ratification is both too wide and too narrow. It is too narrow in that it works only where a wrongdoer happens to have enough votes to make a difference to the outcome. It is too wide in that where a wrongdoer does happen to have enough votes to save herself, it entirely avoids the possibility of an action, denying the court any chance to review the director’s behaviour.

\(b\) *The treatment of ‘fraudulent’ breaches of duty*

As we have seen, at common law there was considerable uncertainty as to the consequences of a duty being categorised as fraud. However, the orthodox view was that such a breach was simply incapable of being ratified, even by a disinterested shareholder vote. But this effectively disenfranchised any disinterested shareholder who favoured ratification. To be sure, the decision in *Smith v Croft (No 3)*\(^89\) did at least allow an independent organ to decide the company should


\(89\) *Op cit* n57.
not sue, and such a decision would be binding on the minority. Nevertheless, such a decision was revocable; the company remained free to change its mind and launch proceedings against the wrongdoer. Hannigan has defended this differential treatment of ratification, and decisions not to sue, arguing that the law’s refusal to permit fraud to be irrevocably excused ‘is important in terms of identifying core standards of corporate behaviour’. But whose interests does it actually serve for the law to impose an outright ban on companies ratifying some breaches, rather than, say, controlling more rigorously the process by which ratifications must be effected?

First, perhaps an outright ban on ratifications of some breaches of duty is necessary to protect minority shareholders opposed to ratification. Yet majority rule is a well-established feature of our company law, and some further argument is necessary why it should not apply when deciding whether to release a director from some breaches of duty. Such an argument might be based on the historically lax voting process that was applied to ratification, which clearly provided minorities with little protection against controlling wrongdoers. Yet this argument has a number of weaknesses. First, it justifies a tightening up of voting procedures, not the entire removal of some matters from the scope of majority rule. It may be unfair to force minorities to submit to a ratification procured with the votes of the wrongdoers, but not to a ratification passed independently of their influence. Moreover, merely removing some breaches from the operation of an overly lax process of ratification would hardly cure the defects of that overly lax process in respect of non-fraudulent wrongs. Finally, concern for minority

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90 See supra text with n59.

91 Admittedly, in many companies there would be no real likelihood of the company ‘changing its mind’ so long as the existing shareholders remain in control, although things might well be different if the company were to be sold.

92 Hannigan op cit n23, p.504.

shareholders does not explain or justify the law’s distinction between ratifications and decisions not to sue. If it is unfair to impose on existing minorities a decision to ratify fraudulent wrongs, why is it not also unfair to impose upon them a decision not to sue? Of course, the law’s eventual acceptance that decisions not to sue should be binding on minorities was conditional on such decisions being taken independently of the wrongdoers. But this merely reinforces the preceding point: what matters is the rigour of the voting process.

Does a concern for the interests of future shareholders, who will suffer when they find themselves bound by a decision to ratify that was taken before they became members, justify precluding the ratification of some breaches of duty? Again, the answer must be no. A future member will take the company as she finds it when she decides to join. Even if its value were to be depressed by directorial misconduct before she became a member, and in respect of which the company had irrevocably given up the right to sue, the price this new member will pay for her shares will presumably reflect this. Future members are much less deserving of sympathy than are current minority shareholders who find that their shares fall in value during their membership; if the latter are to be bound by such a decision, then future members should be too. Finally, even if (implausibly) it were felt that future members should be protected against prior breaches of duty, this would hardly justify holding only fraudulent breaches of duty to be unratifiable, but would instead seem to require future members to be protected against the earlier ratification of any breach of duty.

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94 See supra text with n59.
95 See Payne, op cit 9, p.619.
96 Note however s 260(3) continues to permit members to bring derivative proceedings in respect of corporate acts or omissions which occurred prior to the date they became members, promising a windfall where the price the members paid for their shares already reflected such past misconduct.
97 Take, for example, the purchaser in Regal (Hastings) Ltd v Gulliver op cit n30. Would any injustice be done to such a purchaser if the directors’ wrong had been ratified irrevocably?
Does the protection of non-shareholder groups require that some breaches of duty be unratifiable? The purpose of most duties, although owed to ‘the company’, is nevertheless to protect shareholders’ interests, at least whilst the company remains solvent. For such shareholder-protecting duties, third parties can have little complaint if shareholders choose to forego the protection they confer. However, different considerations do apply where the company succumbs to insolvency. A seam of case law has suggested that, once a company is actually insolvent, or on the verge of insolvency, the interests of the company become the interests of its creditors. Moreover, a liquidator, seeking to swell the assets of the company, might also wish to sue in respect of the past breach of other duties. This might seem to justify precluding the (irrevocable) ratification of some wrongs, even whilst enforcing decisions not to sue in respect of them. Ratification, if effective, would bind a liquidator, whereas a decision not to sue would not.

However, this hardly justifies treating all fraudulent wrongs, but only fraudulent wrongs, as inherently non-ratifiable. First, some breaches of duty that harm creditors – such as a failure to have regard to their interests when the company is on the verge of insolvency – might well not

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98 See now Companies Act 2006, s 170(1).
99 This is surely true even of Companies Act 2006, s 172 of the. Whilst this does indeed require directors ‘to have regard to’ the interests of a variety of constituencies, the ‘benefit of the members’ is still the ultimate purpose behind this other-regarding requirement.
100 This common law development is explicitly acknowledged by s 172(3).
102 See eg Extrasure Travel Insurances Ltd v Scattergood [2002] WL 31599760 (duty to act for proper purposes).
amount to fraud. Second, to preclude ratification of any fraudulent wrong would restrict shareholders even in cases where no question of creditor protection arose.

Finally, do shareholders themselves – and in particular, even an independent and disinterested majority voting in favour of ratification – need to be protected against their own folly in ratifying. At first sight, this looks implausible. Once it is accepted that a majority of independent shareholders should be able to bind the minority (by a decision not sue), why should they not also be allowed to bind themselves (by a decision to ratify). But perhaps some case might still be made for a paternalistic protection even for ‘independent’ shareholders. Many commentators\textsuperscript{103} have emphasised the collective action problems,\textsuperscript{104} and the limited information and bounded rationality,\textsuperscript{105} from which shareholders suffer. Particular emphasis has been placed on the extent to which shareholders rely for their information on directors themselves. If directors can manipulate such information, then ratification could easily become a meaningless rubber-stamping exercise that wrongdoers can easily procure.\textsuperscript{106} This is especially so in larger companies, where shareholders are frequently far removed from the day to day operations of the company, and where it rarely pays individual shareholders to become well-informed about the merits of a proposed ratification. The problem may be less intense for institutional investors,


\textsuperscript{104} This difficulty arises because voting to approve, or reject, a ratification is a ‘collective action’, where the temptation is to free-ride on the efforts of one’s fellow shareholders. See generally E.B.Rock, ‘The Logic and (Uncertain) Significance of Institutional Shareholder Activism’ (1991) 79 Georgetown L.J. 445.


\textsuperscript{106} Parkinson, op cit n76, ch8.
given their comparatively larger holdings, but empirical evidence suggests even they have tended to remain largely passive, despite exhortations to the contrary. Macey also observes that activism is far more likely to occur in respect of a ‘systemic governance issue’ (where an investor’s benefits of intervention are likely to be felt across a large number of companies within the investor’s ‘portfolio’) rather than an issue which affects only a single company. Yet a decision to ratify is, quintessentially, a single-company decision.

Nevertheless, such concerns once again fail to justify the distinction the common law draws between fraudulent and non-fraudulent wrongs. First, insofar as shareholder ratification is an unreliable process for absolving directors, it is so as much in relation to non-fraudulent as to fraudulent wrongs. Shareholders might come to regret a decision to ratify a costly instance of non-self-serving negligence much more than a decision to ratify a relatively trivial instance of misappropriation of corporate property. Second, concerns that directors might manipulate the information available to shareholders can be addressed to some extent, and in respect of all ratifications, by imposing stringent conditions as to the information which must be disclosed to shareholders.

Yet even if shareholders are given all relevant information, there is no guarantee they will make use of it. And even independent and disinterested members might reach bad, irrational, decisions to ratify their directors. But this problem could again arise as much in respect of a non-fraudulent as of a fraudulent wrong. It is, therefore, hardly solved by disregarding every

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107 See Koh, *op cit* n93, p386.
110 Examples of such multi-company issues would be the terms of a new corporate governance code, to be imposed on all listed companies, or the acceptable structure of executive remuneration packages.
ratification (many of which might be perfectly rational), but then only in respect of an (ill-defined) sub-set of fraudulent wrongs. Far better to give the courts a power to review the weight to be accorded to every decision to ratify,\(^{111}\) by making any ratification a factor to take into account, but not an absolute bar, when a court decides whether to permit a derivative claim to continue.\(^{112}\)

(c) Towards a voting based approach

The defects in the common law are, then, inherent in the transaction based approach, and their cure, it is argued, should be achieved through its replacement with what has been termed a ‘voting based’ approach. This would abandon the distinction between fraud and non-fraudulent wrongs. All breaches of duty would be ratifiable,\(^ {113}\) and all prospective breaches of duty would be capable of being authorised, but ratification or authorisation would have to be effected by a sufficiently rigorous process. Since the voting based approach avoids the distinction between fraud and non-fraud, prevents self-interested voting, and permits all wrongs to be ratified, it promises to avoid the defects in the transaction based approach described above. The strength of the case for that approach, then, largely depends upon how compelling the reader finds the aforesaid criticisms. However, concerns have been raised against the practicality of a voting based approach, and these alleged flaws in the voting based approach do deserve consideration.

First, we should clarify what its ‘more rigorous’ voting process entails? Payne suggests three possibilities: that courts be entitled to ignore any ratification not passed in the best interests


\(^{112}\) For discussions of the operation of such a regime in Hong Kong, see J.L.Yap, ‘Reforming Ratification’ [2011] 40 Common Law World Rev.1.

\(^{113}\) Or, at least, insofar as the duty protected the interests of shareholders.
of the company, that any ratification be required to be passed unanimously, or that courts be free to ignore the votes of some shareholders in deciding whether a ratification has been passed.\textsuperscript{114}

The first possibility adopts the same judicial control that applies to alterations of a company’s articles of association.\textsuperscript{115} Yet such a judicial control has provided scant protection for minority shareholders challenging such alterations,\textsuperscript{116} and it is questionable whether it would prove any more effective in controlling inappropriate ratifications. Most troublingly, the test applied by the court in reviewing alterations has typically been expressed in subjective terms; what matters is whether the shareholders thought the alteration was in the best interests of the shareholders, not whether the court felt it to be so.\textsuperscript{117} To be sure, this subjectivity might be qualified by permitting judicial intervention where ‘no reasonable shareholder’ could have felt the alteration to be beneficial to the company’s interests.\textsuperscript{118} Yet this hardly resolves the dilemma. Any subjective test – however qualified it might be – must by definition give some presumptive weight to the views of the shareholders themselves. Yet if that is to be done, one would surely want such weight to be accorded only to shareholders whose views can be trusted.

Whereas a requirement that ratifications be passed in the best interests of the company is too weak, requiring all ratifications to be passed unanimously is too restrictive. It gives a power of veto to any individual shareholder who chooses to object to a ratification. And whilst such

\begin{footnotesize}
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\item \textsuperscript{114} Payne, op cit n9, pp618-625.
\item \textsuperscript{115} Allen v Gold Reefs of West Africa Ltd [1900] 1 Ch 656.
\item \textsuperscript{116} See for example Greenhalgh v Arderne Cinemas Ltd [1950] 2 All ER 1120; Citco Banking Corporation NV v Pusser’s Ltd [2007] 2 BCLC 483 [PC].
\item \textsuperscript{117} Admittedly, a more objective review was applied in cases in which articles were altered in order to facilitate the expropriation of a minority shareholder. However, this approach may also have to be reviewed in light of the decision in Citco Banking Corporation NV v Pusser’s Ltd ibid, discussed in R. Williams, ‘Bona Fide in the Interests of Certainty’ [2007] 66 Camb. L.J. 500. See generally Davies and Worthington op cit n10, paras.19.11-19.22.
\item \textsuperscript{118} Such a formulation was adopted in Shuttleworth v Cox Bros & Co [1927] 2 KB 9.
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objectors may honestly believe it is in the company’s best interests not to ratify, they may also be using that power of veto for purely personal ends, to extract benefits from the company.\footnote{On the risks associated with powers of veto, see H.A. Hansmann, ‘Corporation and Contract’ (2006) 8 American Law and Econ. Rev. 1; C.A. Riley, ‘The Not-so Dynamic Quality of Corporate Law: A UK Perspective on Hansmann’s “Corporation and Contract”’ (2010) King’s Law Journal 469.}

That leaves voting processes that ignore the votes of some members. Whose votes should be excluded? Our earlier discussion suggests that it ought to be those whose personal interest in the vote might illegitimately conflict with the maximisation of the value of the company. Such a rule echoes that proposed by Vinelottt J in \textit{Prudential}, where he spoke of disregarding the votes of those having ‘an interest [in the ratification] which conflicts with that of the company’\footnote{\textit{Op cit} n38. p.307.}. However, the reference to an ‘illegitimate’ conflict in the rule proposed above captures our earlier idea that shareholders might sometimes have personal interests running counter to the goal of maximising corporate value, and (especially in quasi-partnerships) legitimately anticipate being free to vote to protect those interests even if they decrease the company’s value. To take one example, different shareholders likely have different, but legitimate, investment horizons. A short term investor might oppose a derivative claim that’s likely to be protracted, and whose costs will arise in the short term but whose benefits may accrue only after the shareholder anticipates leaving the company. Such a member has a personal interest in the matter, but not one that would be likely regarded as illegitimate.

A rule excluding the votes of those with illegitimate interests could be expressed just in those terms, leaving it to the judge in each particular case to decide what personal interests each shareholder had, and whether they are likely to conflict illegitimately with the maximisation of the company’s value. But such a ‘muddy’ rule would hardly promote certainty and predictability. Better to provide, \textit{in addition} to the exclusion of those with illegitimate conflicting interests, that those who are not \textit{independent} of the wrongdoers should automatically
be precluded from voting, thereby creating an irrebuttable presumption that such members have an interest conflicting with that of the company.

Two criticisms of excluding members from voting might be advanced. One concerns the infringement of a member’s property rights 121 which such an exclusion entails, and has been rejected already. 122 The other is the alleged impracticality of such a system. First, it may be said that any test based on the ‘independence’ of a member will lack certainty, at least if not restricted to certain specified relationships. Yet the uncertainty here is of a quite different order to that which we saw afflicts the definition of fraud in the transaction based approach. The concept of fraud lacks precision because there is no sound policy underlying the distinction between fraudulent and non-fraudulent wrongs in the first place. But the purpose in excluding those who are not independent of the wrongdoers is clear, and defensible, and that purpose can be used to produce a more tailored meaning of independence in individual cases.

Second, applying tests of independence and disinterest to the large number of shareholders in a public company will, it is claimed, make the process too cumbersome, slow and expensive. 123 Yet the problem seems exaggerated. In companies with large numbers of shareholders, the reality is that the overwhelming majority of members will be independent and disinterested. Votes for ratification will likely be passed with sufficient majorities to mean that, even if some doubt might afterwards be raised as to whether a particular member ought to have been entitled to vote, any such irregularity will likely have made no difference to the outcome of the resolution. Third, and finally, it might also be said that the benchmark of a ‘company’s interests’, against which any member’s right to vote is to be judged, lacks substance. Companies

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121 Sealy (op cit n75 at p.32) also criticises the exclusion of some members’ votes for being ‘undemocratic’. But the nature and extent of the democracy that is to operate within a company ought to be the outcome of the same contractarian process of hypothetical bargaining discussed above. A ‘democracy’ objection, then, arguably fares no better than a ‘property rights’ objection.

122 See supra text following n76.

123 J.E. Parkinson, op cit n76, p256.
are, after all, legal fictions, with no interests of their own. However, for the reasons developed in Part III, the company’s interests with regard to any ratification are clear, being definable in terms of the maximisation of its value. And, it is worth noting in passing, this is essentially the test that is now being employed by the courts, when deciding whether to give a claimant permission to continue a derivative claim, and asking what view a ‘hypothetical director’ would take of the claim’s continuation.  

IV RATIFICATION UNDER THE COMPANIES ACT 2006

To what extent did the Companies Act 2006 successfully address the defects in the common law described above? The Law Commission, whose work formed one of the foundation stones of the reform process that led to the Act, had already noted the importance of ratification to the scope of the derivative action, adding, with stereotypically English understatement, ‘it is not always clear when ratification will be effective’. The Commission argued, however, that ratification was outside its terms of reference, and therefore declined to offer its own recommendations for reform. It did, nevertheless, come to recommend that an actual, and ‘effective’, ratification should continue to be an absolute bar to a derivative claim. What would amount to effective ratification would be determined in accordance with the existing law, a position which the Commission itself conceded raised the ‘danger that our desire to simplify the derivative action could be undermined by the complexities which arise where it is claimed that the relevant breach of duty has been (or may be) ratified.’

124 See supra n81.
126 The Commission recommended that ratifiability, without actual ratification, should be a matter the court could merely take into account: Law Commission op cit n2, para 6.84.
127 Ibid, para 6.81.
If the Law Commission was able to sidestep these thorny issues by pleading its limited terms of reference, the Company Law Reform Steering Group ('CLRSG'), the body charged with the oversight of the *Modern Company Law Review*\(^{128}\) which was to lead to the Act, had no such excuse. And the CLRSG seemed commendably willing to consider reform to the principles governing ratification, at least as they would be relevant within the context of the derivative claim. In its consultation document, *Developing the Framework*,\(^{129}\) it accepted that ‘modernisation and simplification’ of the law on ratification might be appropriate and that, moreover, the ‘principles which should apply are clear’.

These principles suggested a strong preference for the ‘voting-based approach’. Whether a derivative claim should be allowed to proceed, it was argued, depended upon whether any decision not to sue ‘has been taken by, or was dependent on, the votes of the wrongdoers or those under the influence of the wrongdoers’.\(^{130}\) Were a decision tainted in this way, then ‘it should clearly not be valid to preclude a derivative action’.\(^{131}\) Ratification (or a decision not to sue) taken independently of the wrongdoers was envisaged as sufficient to preclude a derivative action, and that conclusion ‘did not inherently depend on the character of the conduct complained of’.\(^{132}\) These views survived largely intact in the CLRSG’s next consultation document, *Completing the Structure*.\(^{133}\) Decisions to ratify should ‘depend on whether the necessary majority had been reached without the need to rely upon the votes of the wrongdoers,'

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\(^{130}\) *Ibid.*, para.4.135

\(^{131}\) *Ibid.*, para.4.136

\(^{132}\) *Ibid.*, para.4.135

or of those who were substantially under their influence, or who had a personal interest in the
condoning of the wrong’.\textsuperscript{134} Crucially, this was to apply ‘whether or not [the wrong was] a
fraud’,\textsuperscript{135} whilst the CLRSG noted that ‘no responses [to its consultation] favoured retention of
the old-fashioned “fraud on the minority” test as the basis for founding derivative actions’.\textsuperscript{136}
The CLRSG’s Final Report reiterated this preferred approach without further amendment.\textsuperscript{137}

The Act followed the CLRSG’s recommendation by replacing\textsuperscript{138} the common law
derivative action with a new ‘statutory derivative claim’.\textsuperscript{139} Yet whilst attempting to divorce the
new law from the old, the Act made only a limited change to the process by which ratification is
to be achieved, and no change at all to the definition or consequences of fraud. The failings of
the Act are best assessed by considering its impact on the criticisms of the common law set out in
Part III above.

\textit{(i) The treatment of non-fraudulent wrongdoing}

The Act did at least go some way towards addressing the law’s lax treatment of non-
fraudulent breaches of duty. First, recall that no common law derivative action could be brought
in respect of a non-fraudulent breach, whether or not such a breach had actually been ratified: mere ratifiability sufficed to preclude such proceedings. Now, however, it seems beyond doubt
that derivative proceedings can be brought for \textit{any} breach of duty, whether or not it would

\textsuperscript{134} Ibid. para 5.85.
\textsuperscript{135} Ibid.
\textsuperscript{136} Ibid. para 5.86.
2000), para 7.46.
\textsuperscript{138} By section 260(2) Companies Act 2006, derivative proceedings may now only be brought under Part 11 (or
pursuant to an order of the court in ‘unfair prejudice’ proceedings (under section 994 Companies Act 2006).
\textsuperscript{139} The proceedings in England, Wales and Northern Ireland bear this name. In Scotland, they are called
‘derivative proceedings’.

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constitute ‘fraud’. So, section 260(3) identifies the wrongs for which a claim may be brought,\(^{140}\) with no mention that such wrongs must also amount to fraud. Moreover, whilst an effective actual ratification\(^{141}\) remains a bar\(^ {142}\) to the court granting permission for the continuation of a derivative claim under the Act,\(^ {143}\) that very requirement of an actual ratification shows that mere ratifiability alone no longer precludes a derivative claim.\(^ {144}\)

Further, the right of wrongdoers to excuse their own wrongdoing has also been curtailed. Section 239(3)-(4) requires any ratification to be an ‘unconnected’ one, that is passed without the votes of the wrongdoer or any person connected with him.\(^ {145}\) However, the scope of this reform is limited, and in several ways. First, the requirement of an unconnected vote applies only to ratifications; there is no such requirement in respect of prior authorisations.\(^ {146}\) Second, the Act excludes the votes only of those who are connected with the wrongdoer. By contrast, the

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\(^{140}\) Namely ‘an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company’.

\(^{141}\) Permission must also be refused where the wrong has been authorised by the members in advance; see s263(2)(c)(i). In the absence of actual ratification, the likelihood the wrong would be ratified after it has occurred, or authorised before it occurs, is a factor the court must take into account in deciding whether to give permission for the claim to continue

\(^{142}\) s 263(2)(c)(ii).

\(^{143}\) Under s 261, a claimant must obtain the court’s permission to continue a derivative claim. (In Scotland, the court’s leave must be obtained to raise derivative proceedings: Companies Act 2006, s 266.) On the permission requirement, and the factors that must be applied by the court in determining whether to grant permission, see A Keay and J Loughrey, ‘Something old . . etc’ op cit n5, pp.479-497.

\(^{144}\) In Parry v Bartlett [2011] EWHC 3146 (Ch) Counsel for the defendant director argued that mere ratifiability was sufficient to require permission to continue the claim to be refused. Although clearly erroneous, the judge dealt with this only by finding that the wrong in question was not ratifiable.

\(^{145}\) This is generally assumed to be so (see for example D.Kershaw, op cit n88, p.613) although the Act is silent as to the process for granting authorisation.
Company Law Reform Bill, as originally drafted, required any ratification to be disinterested, that is effected 'without the votes of members with a personal interest, direct or indirect, in the ratification'. There was concern, however, that this terminology of ‘a personal interest, direct or indirect, in the ratification’, lacked certainty. ‘Connected persons’, by contrast, are defined in exhaustive (and exhausting) detail within the Act itself.

Yet whilst the category of ‘connected persons’ may be more certain, it also gives the court substantially less flexibility in determining whether it is inappropriate for a particular shareholder to join in the vote, given the specific details of her relationship to a wrongdoer, or her interest in the transaction in question. Worse still, the concept of a ‘connected person’ within the Act was simply not designed for the purpose of excluding some members from voting on matters in which they have an illegitimate personal interest. It was, rather, designed to extend the definition of a director, in situations where liability was being imposed on directors for benefits they might have improperly secured. It catches those who, in virtue of being benefited, benefit a director. It does not catch all those who, for example, may be so influenced by, or so dependent upon, a director, that they cannot be trusted to vote in the best interests of the company. To take but one example, the definition of connected persons does not include those who have a close business relationship (other than being members of a partnership) with a director. These limitations in the definition of connected persons were thrown into sharp relief in Franbar Holdings Ltd v Patel, which we consider below. Perhaps these problems with the law’s exclusion of the votes of only ‘connected persons’ would be a price worth paying, in order

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147 See clause 216(4).
148 See ss 252-6.
149 [2008] BCC 885.
to avoid the uncertain terminology of ‘disinterested members’. Yet such an argument sits uneasily with the Act’s retention of that very concept in section 263(4).\(^\text{150}\)

Finally, whilst the Act commendably no longer treats mere ratifiability as sufficient to preclude a derivative claim, still actual ratification is, as we have seen, a mandatory bar to the court granting permission to continue a claim.\(^\text{151}\) The court therefore enjoys no discretion to judge the rationality of an actual ratification, or to measure it against its own assessment of the merits of continuing a claim, and thus to respond to the concerns noted above about the ability of even independent and disinterested shareholders to decide whether a director should be released from a breach of duty.

(ii) The treatment of fraud and the law’s lack of clarity

It will be convenient to take these two defects in the common law together, for the latter is so largely a product of the former. How does the Act now deal with fraudulent wrongs? Is this concept even preserved within the new statutory scheme, and if it is, do such wrongs remain, as the orthodox account of the common law maintained, wholly unratifiable? We have already noted that the Act no longer requires the wrong in respect of which a derivative claim is being brought to constitute ‘fraud’. Nor, in fact, does it expressly refer to fraud in setting out the possibility of ratification. Instead section 239 merely provides, in subsection (7), that ‘[t]his section does not affect . . . any rule of law as to acts that are incapable of being ratified by the

\(^\text{150}\) Companies Act 2006, s 263(4) requires the court, when deciding whether to give permission to a claimant to continue a derivative claim, to have ‘particular regard . . . to the views of members of the company who have no personal interest, direct or indirect, in the matter’. For judicial interpretation of that wording, see *Iesini v Westrip Holdings Holdings Ltd op cit* n80, pp450-1, para.129.

\(^\text{151}\) The Law Commission, in its *Shareholders’ Remedies: A Consultation Paper* (Law Comm. Consultation Paper 142) para16.35, favoured making ratification a merely discretionary factor. However, by the time it published its *Report, op cit* n2, para6.84, its attitude had changed, and it recommended that ratification should be an absolute bar.
Thus, the Act falls back on the common law. Likewise, the Act simply preserves, untouched, the common law position as to which wrongs which are, or are not, capable of being authorised.

Yet in preserving the common law rules in this way, the Act inevitably also preserves all the uncertainties to which the common law was subject. The Act does nothing to resolve the common law’s lack of clarity about the definition of fraud. Nor does it do anything to resolve the conflict between the orthodox and the heretical interpretations of shareholders’ ability to ratify fraudulent wrongs. For a reform process lasting nine years, and aiming to produce a more certain and comprehensible body of law, this is a sad indictment of its efforts. It is also a badly missed opportunity to realise the benefits of a voting based approach to ratification. By preserving the common law rules, the Act necessarily preserves the transaction based approach which was integral to that common law position. Whilst fraud may no longer be a precondition to the bringing of a derivative claim, sparing litigants the vagaries of classifying the breach of duty which is the subject of the claim, that task inevitably arises in deciding whether, or how, the breach might be effectively ratified.

Might it not still be possible, however, finally to conjure a voting based approach from the new statutory framework? Could this not be achieved by taking the requirement in section 239 that all ratifications must now be ‘unconnected’, and combining this with a heretical interpretation of the ability to ratify even fraudulent wrongs? The attempt might proceed as follows. If the common law were to be interpreted (heretically) as permitting even fraud to be ratified, provided such ratification were sufficiently rigorous, then an unconnected ratification

152 For Parliamentary acknowledgement of the common-law-preserving nature of clause 216 of the Bill, which became s 239 of the Act, see Hansard, 9 Feb 2006 : Column GC368.

153 See s 180(4), which provides that ‘[t]he general duties (a) have effect subject to any rule of law enabling the company to give authority, specifically or generally, for anything to be done (or omitted) by the directors, or any of them, that would otherwise be a breach of duty’.
could be accepted as satisfying that requirement of rigour. Fraud, like non-fraud, would then be capable of ratification, but both would require the same, unconnected, vote. No longer would it matter whether a wrong was to be regarded as fraud or non-fraud, finally allowing the distinction to be buried as irrelevant.

Sadly, however, such a strategy is bound to fail. First, even if it worked for ratifications, it could not work for authorisations. As we have seen, the Act still permits wrongdoers to vote on an authorisation. Even if we interpreted the common law, heretically, to permit all wrongs to be authorised, fraudulent wrongs would have to be authorised by some process more rigorous than the self-interested voting that the Act still permits for non-fraudulent wrongs. Second, the strategy cannot work for ratifications either. For a heretical interpretation of the common law could not, from both a doctrinal and a policy point of view, accept a merely unconnected ratification as sufficiently rigorous to excuse a breach of duty. The policy argument should by now be clear: a defensible voting based approach must require a disinterested vote, yet the exclusion only of votes cast by those ‘connected’ with the wrongdoer is narrow, inflexible, and insufficiently controls the exercise of votes harmful to the company’s commercial interests.

As to the doctrinal point, those cases which lend support to the heretical interpretation of the common law surely envisage something more demanding than a merely ‘unconnected’ vote. Vinelott J in *Prudential* spoke of fraud being ratifiable provided the wrongdoers ‘did not control the company’ and the majority ‘does not have an interest which conflicts with that of the company’. These are rather more open-ended, flexible and demanding conditions than the narrow and technical statutory rules excluding only ‘connected persons’ from voting. Similar observations apply to the decision of Knox J in *Smith v Croft (No 3).*154 Although Knox J sought to identify the preconditions only for a binding decision not to sue, the preconditions for a

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154 *op cit* n57.
binding decision to ratify should surely be at least as demanding.\textsuperscript{155} And for a binding decision not to sue in respect of a fraudulent wrong, Knox J explicitly required a decision that was taken only by shareholders who were independent of the wrongdoers, a characteristic he discussed at some length. Ultimately, he focused on whether a shareholder’s votes were likely to be exercised \textit{bona fide} for the benefit of the company as a whole, a test derived from cases in which alterations of the articles were impugned.\textsuperscript{156} Although this focus on a shareholder’s likely \textit{motive} is not the one the current writer would prefer, nevertheless it is clearly quite different from the concept of ‘connectedness’.\textsuperscript{157}

\textbf{V: \textit{Franbar Holdings Ltd v Patel}}

The impossibility of conjuring a voting based approach from the Act, and the inevitable survival of a transaction based approach with its many defects, is starkly demonstrated by the case of \textit{Franbar Holdings Ltd v Patel}.\textsuperscript{158} The facts were relatively straightforward. Franbar owned 25\% of the shares of Medicentres (UK) Ltd. The remaining shares were all owned by Casualty Plus Ltd (‘CP’), which had appointed two directors to the board of Medicentres. Franbar had an option to sell its shares in Medicentres to CP, and CP likewise had an option to purchase Franbar’s shares. The relationship between Franbar and CP broke down. Franbar made a number of allegations against CP’s two appointed directors, including that they had caused business opportunities intended for Medicentres to be diverted to CP. Franbar brought

\begin{quote}
\textsuperscript{155} Indeed, given its irrevocable nature, a decision to ratify should arguably require a more demanding process, especially in terms of the information held by shareholders, than should a decision not to sue.
\textsuperscript{156} See eg \textit{Allen v Gold Reefs of West Africa Ltd} [1900] 1 Ch. 656, \textit{Greenhalgh v Arderne Cinemas Ltd} [1951] Ch 286.
\textsuperscript{157} Kershaw seems to take a somewhat different view (\textit{op cit} n88, p.654). His argument is that, assuming that fraud is only unratifiable where ratification would involve ‘oppression’ of the minority, then the requirement of an unconnected vote under s 239 effectively precludes such oppression. The difficulty that \textit{Franbar infra} presents for this argument is not considered.
\textsuperscript{158} [2008] BCC 885.
\end{quote}
(amongst other proceedings)\textsuperscript{159} a derivative claim against CP’s two appointed directors, and sought the court’s permission to continue that claim.

Although there had been no actual ratification, the court, in deciding whether to grant permission, still had to consider the likelihood that the wrongs would be ratified in the future.\textsuperscript{160} Counsel for the defendant directors argued ratification was likely, since CP would use its 75\% shareholding to vote in favour. Of course, if CP were connected with the defendant directors, CP’s votes could not be counted on the resolution. However, although CP was hardly independent of the directors it had itself appointed, and was surely interested in any vote to ratify their alleged misconduct,\textsuperscript{161} the court found no evidence that ‘Casualty Plus is a person connected to either of them in the sense for which provision is made by s254.’\textsuperscript{162}

Unable to show that Casualty Plus would be precluded, by section 239(4), from voting for ratification, Franbar argued instead that the wrongs in question would not, in any case, be ratifiable at common law. Deputy judge William Trower QC noted that section 239(7) expressly preserved any rule of law by which acts were incapable of ratification, which would include\textsuperscript{163} acts amounting to a fraud on the minority.\textsuperscript{164} Nevertheless, he did not seem to view the common law as preventing fraud from being ratified under any circumstances. Rather, he appeared to

\begin{enumerate}
\item\textsuperscript{159} Besides its derivative claim, Franbar also brought proceedings for breach of a shareholders’ agreement, and under Companies Act 2006, s 994 (for unfair prejudice).
\item\textsuperscript{160} Under s 263(3)(d).
\item\textsuperscript{161} One reason for this, according to the evidence of Franbar, was that one of the motives for the directors’ misbehaviour towards Medicentres was to drive down its value, and thus the price that would be payable by CP if it exercised its option to acquire Franbar’s shares. Forcing the directors to reimburse the company would increase its value and thus the price payable by CP.
\item\textsuperscript{162} Op cit n158, para42, emphasis added.
\item\textsuperscript{163} As noted above, acts might be incapable of ratification on other grounds; see supra at n18 and the text therewith.
\item\textsuperscript{164} He accordingly rejected an argument by counsel for the defendants that the requirement of an unconnected ratification in s 239(4), had effectively replaced all earlier common law rules regarding which wrongs were incapable of being ratified.
\end{enumerate}
view even fraud as ratifiable, but provided this did not constitute an exercise of wrongdoer control which would ‘have the effect that the claimant is being improperly prevented from bringing the claim on behalf of the company’. Thus, fraud was ratifiable, it seemed, so long as the vote to ratify didn’t involve the wrongdoers using their control of the company. True, the point isn’t put quite as clearly or explicitly as one might wish. The judge did, for example, say that ‘some of the complaints made by Franbar may well be incapable of ratification’. But the whole judgement is expressed in the context of ratification being effected by the wrongdoers in control, and the foregoing passage is surely to be interpreted as meaning ‘incapable of ratification by Casualty Plus’, an interpretation supported by the next sentence of the judgement, where his Lordship argues that some of the directors’ alleged misbehaviour might well amount to ‘a breach of duty incapable of ratification on the votes of Casualty Plus’.

What would ensure a vote did not amount to an exercise of wrongdoer control was not identified in detail. However, and crucially for the analysis offered in this article, it clearly required something more than its being ‘unconnected’. As his Lordship noted, a claimant might be being improperly prevented from suing even ‘where the new connected person provisions are not satisfied, but there is still actual wrongdoer control pursuant to which there has been a diversion of assets to persons associated with the wrongdoer, albeit not connected in the sense for which provision is made by s.239(4)’. A distinction, then, was to be drawn amongst the various breaches of duty alleged against the directors. Those breaches that did not amount to fraud would be ratifiable by a merely unconnected vote (and, since CP was not connected, ratification in respect of those was likely). Those breaches which were to be categorised as fraud

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165 Franbar op cit n158, para 45.
166 Ibid, para 47.
167 Ibid, emphasis added.
168 Ibid, para 45.
could only be ratified without the votes of CP (since if CP were to vote, this would amount to an impermissible exercise of wrongdoer control).

Thus, the court’s apparent (heretical) readiness to permit the ratification even of fraud, and even when combined with the Act’s requirement of unconnected ratifications, was still insufficient to disturb the common law’s transaction based approach. Breaches of duty were still to be categorised as fraudulent or non-fraudulent, with the process for their ratification varying according to the category into which the breach of duty fell.

If the case illustrates the inevitable retention of a transaction based approach under the Act, so too does it remind us of the uncertainties of that approach. First, although one might welcome Deputy Judge Trower’s acceptance that fraud could be ratified, if done in the right way, the case was only a first instance decision, and ratification only one (and surely not the weightiest) factor in the judge’s decision whether to give permission for the derivative claim to continue. It will take more than that to resolve the longstanding and deep-seated conflict between orthodox and heretical interpretations of the common law.169 Second, it remains unclear just what would count as an effective ratification in respect of fraud. We do know that a merely unconnected vote would not suffice, but beyond that uncertainty prevails. Whose votes are not allowed to count? Is the test one of relationship with the wrongdoer? Or is it an interest in the vote that debarres and, if so, what sort of interest is fatal? As our discussion of the voting based approach suggested, there are many alternatives here in teasing out the detail of a truly rigorous approach, yet apart from rejecting one possibility (only excluding unconnected votes) Franbar avoids this issue.

169 Ratifiability was also briefly discussed in Parry v Bartlett, op cit n144, paras.78-82. It was held that the misconduct was unratifiable, and this conclusion was arrived following a (very brief) discussion of the common law doctrine on fraud on the minority. However, since the company was owned 50/50 between the claimant and the defendant director, and since the latter would clearly be unable to vote on any ratification, the conclusion that the misconduct was ‘unratifiable’ may have meant no more than that the misconduct was unlikely to be ratified.
Third, the case highlights, yet does nothing to resolve, fraud’s uncertain scope. The defendants’ fraud lay, apparently, in their attempted ‘diversion of assets to persons associated with the wrongdoer’. Yet, as we have seen already, the concept of ‘corporate property’ is fraught with difficulty, especially where those ‘assets’ are mere corporate opportunities. Moreover, some of the alleged breaches of duty suggested only negligence on the part of the defendant directors, albeit such negligence would depress the value of Franbar’s shares in Medicentres. This might not benefit the wrongdoers themselves, but it would benefit CP should it choose to exercise an option it held to purchase Franbar’s shares. Whether such benefit to a third party would be sufficient echoes the uncertainty inherent in a test based on wrongdoer benefit which Vinelott J himself acknowledged in *Prudential*.

Finally it might be wondered whether, in referring to the exercise specifically of ‘wrongdoer control’ as being fatal to the ratification of fraud, the judge was re-introducing a concept that was abandoned by the Companies Act 2006. Recall that at common law, a shareholder could bring a derivative claim only if she was able to establish that the wrongdoers were in control of the company, and preventing it from suing. The 2006 Act, however, says nothing about the claimant shareholder having to establish such control as a precondition to bringing a claim.

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170 See *supra* n40.
171 See *supra* n19.
Although there has indeed been judicial suggestion that wrongdoer control is no longer part of the law governing derivative claims, there has also been judicial and academic comment to the contrary. There is not space here to explore this debate in detail. However, since a voting based approach requires that ratification be effected independently of those with an illegitimate interest in the matter, then this necessarily requires that account be taken of the influence enjoyed by wrongdoers over the voting process. And accordingly the ‘rubric’ of wrongdoer control might continued to be used to capture the sense of whether a vote to ratify was effected independently of the wrongdoers (without necessarily thereby invoking all the past case law that sought to define that concept as it was employed in the common law derivative action).

VI: CONCLUSIONS

It is rarely the case that a job half-done is well-done, and so it has proved in respect of the Companies Act 2006. The Government deserved praise for confronting the unsatisfactory state of derivative proceedings, and made some changes of real benefit. Allowing derivative claims in respect of all breaches of duty, without regard to whether they constitute fraud, is welcome, and requiring unconnected ratifications was at least a modest step in the right

172 See the comments of Lord Reid in the decision of the Inner House in Wishart v Castlecroft Securities Ltd [2010] BCC 161, 196-7 [para38], that the requirement of wrongdoer control, which had ‘given rise to difficulty in a number of cases’, is not repeated in the Act.

173 See for example the comments of Judge Pelling QC in Stimpson v Southern Private Landlords Association [2009] EWCH 2072 [46] that the absence of wrongdoer control was a factor to take into account in deciding whether to grant permission to continue a derivative claim. Note also the cases of Cinematic Finance Ltd v Ryder [2012] BCC 797 and Bamford v Harvey [2012] EWHC 2858 (Ch) in which the courts refused permission to continue derivative claims where the claimant shareholder had sufficient control within the company to ensure that the company itself could sue, obviating the need for derivative proceedings.

direction. But a modest step is ill-advised when the law’s defects demand a courageous leap, and much of the Act’s commendable effort has been undermined by its retention of the indefensible common law rules governing ratification (and authorisation).

As Franbar shows painfully clearly, whilst it may be possible, in applying the common law, to move beyond the orthodoxy’s treatment of fraudulent wrongs as wholly unratifiable, that must be done within the confines of the transaction based approach. Even if all wrongs are to be regarded as ratifiable, the precise process of ratification (and a fortiori of authorisation) must still vary according to whether the wrong in question is, or is not, properly categorised as fraud. It is surely paradoxical that an apparently minor amendment to the Company Law Reform Bill,175 motivated by a desire to achieve greater certainty and predictability, has the entirely unexpected, and far from minor, consequence of entrenching the distinction between fraud and non-fraud, with all the uncertainties and lack of predictability it creates. Things could, and should, have been so different, and the Act will be judged as a badly missed opportunity to adopt the clear benefits of a voting based system to ratification.

175 Specifically clause 216; see supra, text with n146.