

Dispute Resolution
Dispute Resolution Case Law Update
Rosling King LLP



Background

Dr Potamianos is a specialist software creator who worked for Sprint Electric Limited ("SEL"). In 1999 Dr Potamianos became Research and Development Director of SEL holding a 40% shareholding, with Mr Prescott holding a 60% majority. Dr Potamianos created software, known as the "Source Code", and Mr Prescott asserted the intellectual property rights of the software belonged to SEL. Dr Potamianos disputed this.

The relationship between the two directors broke down due to this dispute, resulting in Dr Potamianos being removed as a director of SEL. The company issued proceedings against Dr Potamianos, known as the "Source Code Claim", in order to determine the ownership of the intellectual property rights. Dr Potamianos issued an unfair prejudice petition under s994-996 of the Companies Act 2006 on the basis that he was excluded from participating in management of SEL by the majority shareholder, Mr Prescott.

First Instance Decision

In the first instance, the High Court found as follows:

- (1) that the exclusion of Dr Potamianos from management was unfair. Whilst Dr Potamianos had failed to comply with his duty to the company by being "evasive", "misleading" and "dissembling" with regard to the Source Code, he was entitled to put forward in good faith his own interests and that it was inequitable for Mr Prescott to use his voting power to exclude Dr Potamianos from participation in management without giving him the opportunity to remove his capital on reasonable terms. The judge therefore made a buy-out order;
- (2) a "Balancing Payment" of £4 should be paid to Dr Potamianos for every £6 paid to Mr Prescott to reflect payments received after the exclusion of Dr Potamianos from management; and
- (3) as Mr Prescott had made offers to buy Dr Potamianos's shares before the proceedings commenced, the judge postponed the determination of whether these offers remedied any future unfair prejudice.

Mr Prescott appealed the judge's findings in relation to the unfair prejudice and the resulting financial orders (1 & 2 above), and Dr Potamianos appealed the judge's decision postponing the offers issue (3 above).

The Appeal

1. Breach of Duty

Mr Prescott argued that it was wrong to find that the exclusion of Dr Potamianos from management was unfair as his "evasive", "misleading" and "dissembling" behaviour made his removal as a director justified. It was further submitted that if it was held that Dr Potamianos had breached his duties, this would bring his right to management to an end.

The Court of Appeal upheld the first instance decision and rejected this ground of appeal on the basis that the previous judge had applied all correct legal principals in making the evaluation. There was no identified flaw in the judge's reasoning that justified interfering with his conclusion.

The Court of Appeal explained that Dr Potamianos had engaged in an open and bona fide dispute concerning ownership of the intellectual property rights, in which he was ultimately found to be wrong. His "evasive", "misleading" and "dissembling" behaviour had contributed to the Court's findings in the first instance, however this was not to say that every breach of fiduciary duty would necessarily render exclusion from management fair.

2. Buy-Out Order & Balancing Payment

The Court of Appeal upheld the High Court's decision that the purchase should not be at a discount simply on the basis that Dr Potamianos had acquired his shares at a discount. Applying a discount would have given no consideration to the objective market value of the shareholding, uninfluenced by the price at which it was acquired, as the starting point of price should be valued at the date on which it is ordered to be purchased.

The judge's decision was challenged on the basis that the exclusion of Dr Potamianos was justified and that the Court had ordered the Balancing Payment to compensate Dr Potamianos from being unfairly excluded. A further argument was considered that any payment due to Dr Potamianos should be forfeited under the principal that a fiduciary's remuneration may be forfeited for breach of fiduciary duty.

Both arguments were rejected by the Court of Appeal. Even though Dr Potamianos was in breach of his fiduciary duty, the Balancing Payment was not ordered in light of the unjustified exclusion from management, but instead to reflect Dr Potamianos' joint ownership of the business and his entitlement to a share of the incoming payments.

3. Postponement of the Buy-Out Order

The Court considered that, in the circumstances, Dr Potamianos rejecting the offers made did not justify his exclusion from the company. They could not have been relied upon to defeat Dr Potamianos's petition, therefore the judge had been wrong to defer the offers issue and the decision was reversed in part.

Commentary

This case considers the issues surrounding when a director is in breach of their fiduciary duties and whether the breach will be a bar to seeking redress under an unfair prejudice petition. This case confirms that the Court's approach is very fact specific. This case demonstrates that a serious breach may be required to justify exclusion from management.

There has been much commentary surrounding the factors taken in to account when assessing whether an offer to purchase a minority shareholders' shares is reasonable. Whatever form the

offer takes, the importance of access to information is a factor of considerable practical importance. The offeror may also need to demonstrate that they will be able to fulfil the offer, which may include evidencing how the offer is being funded and the timescale for facilitating payment. Offers expressed as 'subject to affordability' are less likely to be effective. It should be noted that even if an offer is reasonable, and it is unreasonably rejected, there is no obligation on the court to dismiss the petition.

For further information, please contact [Georgina Squire](#) or the Partner with whom you usually deal.