

Advisory | UK Civil Fraud & Business Disputes



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Business Disputes in the UK 2022

This GT Advisory covers the following:

- Breach of directors' duties
- Unfair prejudice petitions
- Breach of contract

Businesses in the UK and around the world have adapted to extraordinary circumstances over the past two years due to the COVID-19 pandemic. Despite the attempts and wishes of those seeking to return to business as usual, the long shadow of COVID-19 (and its variants) continues to play a role in the everyday activity of commercial business. This has also resulted in businesses of all sizes having to acclimate to a “new normal” which gives rise to different risks and opportunities. The number of legal threats and complaints made against UK businesses **reportedly** more than doubled from 2019 to 2021 and increased four-fold since 2016, with businesses more likely than ever to face legal action. Furthermore, in the past five years, more than half (56%) of all businesses have faced an accusation, claim or allegation of unlawful behaviour. This is a trend that may continue, with individuals and businesses more closely considering their legal options and assessing how best to protect themselves in these uncertain times.

This GT Advisory looks at the types of claims businesses, their directors and shareholders may be involved in over the next few years, including allegations of breach of directors' duties, unfair prejudice petitions and breach of contract.

Breach of Directors' Duties

Directors are company agents appointed to run day-to-day affairs. Directors are the stewards of the company's affairs and are subject to various obligations and duties. Sections 170 to 177 of The Companies Act 2006 (CA 2006) identify director duties, which include the following:

- to act within their powers in accordance with the company's constitution;
- to act in good faith and in a manner most likely to promote the success of the company for the benefit of its members as a whole, taking into consideration various matters including likely long-term consequences; employee interests; and community and environmental impact;
- to act fairly as between the shareholders;
- to exercise independent judgment;
- to exercise reasonable care, skill and diligence;
- to refuse benefits from third parties;
- to avoid direct or indirect conflicts of interest;
- to refuse benefits from third parties conferred by reason of being a director or doing (or not doing) anything as director; and
- to declare any interest in a proposed transaction or arrangement that the company intends to enter into.

Directors also owe companies fiduciary duties which arise due to the relationship of trust and confidence between companies and directors. These include:

- not to place themselves in a position where their own interests conflict with the company;
- not to profit from their position at the expense of the company;
- undivided loyalty to the company; and
- using or disclosing information obtained in confidence from the company only for the benefit of the company.

If a director breaches these duties and the company suffers loss, the company could potentially bring claims against the director and/or third parties involved in the breach to recover the losses. Company directors typically would be the ones to decide to commence proceedings, once they have received the benefit of legal advice on the merits and prospects of success. Depending on the company's losses, the remedies it can seek against the director and any third parties that assisted the breach include:

- Damages to cover the losses suffered by the company;
- An account of profits;
- An order to return or restore to the company any personal profit made or property obtained in connection with the breach; and

- Rescission of a contract where the director failed to disclose an interest.

Unfair Prejudice Petitions

The CA 2006 provides further safeguards against company mismanagement and protection to shareholders in the form of unfair prejudice petitions. Section 994 of the CA 2006 provides that a company shareholder may petition for relief where the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of the members.

To obtain relief, the petitioner shareholder must show that the unfairly prejudicial conduct relates to the company's affairs (such as the company's management decisions and commercial strategy) and that it affects the members' interests in their role as members of the company. The test for unfair prejudice is an objective test of what a reasonable person would believe to be unfair in the circumstances. Action commonly considered unfairly prejudicial includes:

- Failure to abide by the articles of association;
- Preventing the petitioner shareholder from being involved in the management of the company, where he/she would otherwise be entitled;
- Excessive remuneration or bonuses to the shareholder/director;
- Allotment of shares to dilute shareholding of others;
- Payment of dividends to certain categories of shareholders and not others without justification;
- Diverting business opportunities to other companies where certain shareholders hold an interest.

Once the petitioner establishes unfair prejudice, the court has a wide discretion to “*make such order as it thinks fit for giving relief in respect of the matters complained of*” (Section 996(1), CA 2006). This includes:

- Ordering the purchase of the petitioner's shares at fair value by other shareholders or the company;
- Authorising civil proceedings to be brought in the name of the company;
- Requiring the company to refrain from an act or to carry out an act that it has omitted to do;
- Prohibiting changes to the company's articles of association.

Due to the economic pressures resulting from COVID-19, some director shareholders have acted in a way which may be perceived as taking unfair advantage of other shareholders. For example, a decision as to whether to pay dividends or to maintain directors' salaries during the pandemic will be closely scrutinised by shareholders. If the cancellation of dividends means a reduction in shareholders' expected returns but a consistent level of director pay (and/or excessive bonuses on top), this may well lead to the consideration and pursuit of unfair prejudice petitions.

Breach of Contract

Contracts can be entered into orally, by conduct or by way of a written agreement. Parties often enter into contracts with a view to setting out the parameters of their rights and obligations; unfortunately, however, sometimes things don't quite go to plan. Allegations of breaches of contract range from anticipatory breaches (when one party realises the other party is not going to comply with the contract and takes

action) to minor breaches (when a party fails to perform a term within the contract, but the remainder of the contract can still be performed as expected) to fundamental breaches (when the breach is severe and either prevents the other party from performing the contract or defeats the purpose of the contract). Breaches of contract can occur in many ways, from delays in providing a service or product, to defects in the product and non-payment for services.

In order to establish a breach of contract claim, the aggrieved party must prove the existence of a contract. The aggrieved party must then demonstrate a breach of the contract which was caused by the other party and which resulted in loss.

The aggrieved party in a breach of contract claim seeks to be made whole and put in the position it would have been in had the contract been performed as agreed. Depending on the damage or loss suffered, the remedies that can be sought for the aggrieved party can include:

- Damages to recover the financial losses suffered as a result of the breach;
- Remedies expressly provided for under the contract – in commercial contracts, parties sometimes agree to specific remedies in certain situations where a party fails to comply with their obligations; these remedies can take the form of liquidated damages clauses or the return of goods for non-payment;
- Specific performance – this is an equitable remedy used by the court to compel the party in breach to perform its contractual obligations where damages would not be an adequate remedy for the loss suffered; and
- Injunction – this is also an equitable remedy granted where damages would not be an adequate remedy. The aggrieved party may apply to prevent/restrain the other party from starting or continuing a breach or to compel it to perform certain acts in order to prevent the breach.

Key Takeaways

Litigation should not be a knee-jerk reaction, particularly in commercial relationships. Use of contractual dispute-resolution clauses may help to narrow issues or problems in a way which preserves commercial relationships. There are also several ways to reduce the risk of a drawn-out court process and resultant legal fees and loss of valuable management time. This requires a proactive approach which may require difficult conversations internally within organisations and strategic steps in relation to third parties. Organisations should be undertaking and implementing comprehensive risk assessments in relation to customers, employees and external third parties, and ensuring such assessments are regularly reviewed. Businesses should also confirm they have insurance coverage adequate for the types of claims they may face or wish to pursue. Communication and clarity on what has happened, alongside a clear understanding of the options available (from a legal, commercial and practical perspective) reduce the business and litigation risks inherent in commercial contracts.

Authors

This GT Alert was prepared by:

- [Annabel Thomas](#) | +44 (0) 203.349.8700 | Annabel.Thomas@gtlaw.com
- [Thai Nguyen](#) | +44 (0) 203.349.8700 | Thai.Nguyen@gtlaw.com

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