'Reasonable Offers' As a Defence to Unfair Prejudice Petitions: *Prescott v Potamianos*

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The definitive version of this article from the Modern Law Review is available at www.wileyonlinelibrary.com with bibliographic reference (2020) 83(2) MLR 443-450.

Abstract: It is long established that a 'reasonable offer' for a petitioner's shares can defeat an unfair-prejudice petition. Lord Hoffmann gave guidance about such offers in *O'Neill v Phillips*. Now, in *Prescott v Potamianos*, the Court of Appeal has set out three factors that help to determine in general whether an offer is 'reasonable'. Those factors are: the value offered; the likelihood of implementation; and the proximity to the unfairly prejudicial conduct. The Court's guidance is useful for lawyers and their clients, as well as being broadly favourable for petitioners. But the Court emphasised that the unfair-prejudice jurisdiction is based on fairness and so requires a considerable degree of flexibility. Such flexibility impairs the certainty that Lord Hoffmann was seeking to promote, and may create difficulties for parties making or receiving offers.

In *Prescott v Potamianos*[1] (*Prescott*), the Court of Appeal explored an important but under-developed aspect of the unfair-prejudice jurisdiction provided by sections 994 and 996 of the Companies Act 2006. The question was: when will an offer made by one shareholder to another suffice to resolve an unfair-prejudice dispute between them? An offer that is sufficient in this way is termed 'reasonable', and the offeree will have his remedy through the

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[1] *Prescott v Potamianos* [2019] EWCA Civ 932 (McCombe, Leggatt, Rose LJJ).

offer and not in court. Usually, the offer is to buy the offeree's shares as an alternative to unfair-prejudice proceedings brought for the same or similar relief.

The judgments in *Prescott* are the first occasion since the leading case of *O'Neill v Phillips*[2] (*O'Neill*) on which the principle relating to 'reasonable offers' has received extensive judicial consideration. This note begins with an overview of the principle and sets out its origin and development. After explaining the Court of Appeal's approach, the note offers some observations as to the benefits and difficulties of applying that approach in future cases.

OVERVIEW OF THE PRINCIPLE

Section 994 of the Companies Act 2006 allows a shareholder to petition the court on the ground that the conduct of the company's affairs is unfairly prejudicial to (at least) the petitioner. Then, by section 996, the court may give such relief as it thinks fit; in particular it may order the other shareholders to purchase the petitioner's shares.

Unfair prejudice can arise from a breach of the terms agreed between the shareholders (for example, those set out in the articles of association); and it may also arise from equitable considerations that in some cases constrain the shareholders' legal powers.[3] Where such equitable considerations apply, the company is usually referred to as a 'quasi-partnership'.

A common form of unfairly prejudicial conduct is exclusion from management, provided the petitioner has a legal or equitable right to participate. Lord Hoffmann, however, emphasised in *O'Neill* that:

[2] *O'Neill v Phillips* [1999] 1 WLR 1092, HL.

[3] n 2 above, 1098G-1099B.

> the unfairness does not lie in the exclusion alone but in exclusion without a reasonable offer.[4]

Subsequent cases have established that 'reasonable offers' will also remedy or prevent unfairness in cases not involving exclusion from management.[5]

Lord Hoffmann then set out '*what counts as a reasonable offer*' because he thought that '*parties ought to be encouraged, where at all possible, to avoid the expense of money and spirit inevitably involved in such litigation by making an offer to purchase at an early stage*'.[6] In short: the offer must be at fair value (usually without a minority discount); it should provide for an expert determination of that value and for 'equality of arms' between the parties; and it must include a payment of costs (if made after the offeror has already had a reasonable time to make an offer).

Lord Hoffmann's guidance is subject to two qualifications. The first is that it was *obiter*, although it has been followed without criticism. The second is that the guidance expressly related to cases where the offer was *plainly* reasonable, so that the petition could be struck out;[7] but the guidance has nonetheless been followed at trial.[8]

APPLICATION OF THE PRINCIPLE IN *PRESCOTT*

In *Prescott*, Dr Potamianos complained that Mr Prescott had unfairly excluded him from management. Mr Prescott relied on four offers he had made to Dr Potamianos, none of which followed Lord Hoffmann's guidelines. Dr Potamianos challenged the reasonableness of the offers on three bases: first, most of the offers were at fixed prices, rather than prices to be

[4] n 2 above, 1107C.

[5] For example, *Apcar v Aftab* [2003] BCC 510 at [24].

[6] n 2 above, 1106H – 1108C.

[7] n 2 above, 1107C.

[8] For example, *Re Flex Associates* [2009] EWHC 3690 (Ch) at [72]-[74] (David Donaldson QC).

determined by an expert (the other offers proposed the appointment of an expert to produce a binding valuation for use in negotiations); second, none of the offers was legally binding (in the sense that a simple acceptance would create a contract); and third, all the offers predated at least some of the unfairly prejudicial conduct complained of.

At the trial of liability,[9] the judge considered that the question of the reasonableness of the offers was logically antecedent to the question of unfair prejudice[10] (the logic being that unfairness can only arise in the absence of a reasonable offer[11]). The judge, however, considered himself unable to answer this first question of reasonableness because expert evidence as to the fairness of the fixed prices would only be available at a subsequent trial.[12] He also deferred the question of whether an offer can remedy unfairly prejudicial conduct that has yet to occur.[13] And he rejected the submission that an offer must be legally binding in order to be reasonable.[14] He went on to find that Dr Potamianos should have relief for unfair prejudice, unless any of Mr Prescott's offers were found (at a later trial) to have been reasonable.[15]

On appeal, the Court of Appeal held that the judge was in a position to assess the reasonableness of Mr Prescott's offers and of Dr Potamianos's responses to them.[16] The Court then considered the offers for itself and concluded that none had been reasonable.[17]

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[9] *Potamianos v Prescott* sub nom *Sprint Electric Ltd v Buyer's Dream Ltd* [2018] EWHC 1924 (Ch) (Richard Spearman QC).

[10] n 9 above, [360].

[11] Cf V. Joffe et al, *Minority Shareholders: Law, Practice, and Procedure* (Oxford University Press, 6th ed, 2018), paragraphs 6.162 to 6.163.

[12] n 9 above, [366]-[372].

[13] n 9 above, [361]-[362].

[14] n 9 above, [373].

[15] n 9 above, [376] and [389]-[404].

[16] n 1 above, [140].

[17] n 1 above, [141]-[145].

The approach leading to this conclusion is explained below. But it is worth saying at once that the Court did not accept any definite rule on any of the three bases advanced on behalf of Dr Potamianos.

THE ORIGIN AND (LACK OF) DEVELOPMENT OF THE PRINCIPLE

The principle that a reasonable offer remedies unfair prejudice has an obscure origin. By the time of *O'Neill*, a practice appears to have grown up of making offers to provide an alternative to starting or continuing court proceedings.[18] The essential argument was that the offer would give the petitioner all he could reasonably expect to achieve at trial, so that proceedings in face of the offer would be an abuse of process.[19] This suggests that an offer has a procedural effect (and not merely as to costs). But, in *O'Neill*, Lord Hoffmann emphasised its substantive effect of remedying unfairness that would otherwise exist. Reasonable offers therefore have a starkly different basis from normal offers of settlement.

The origin of the substantive effect of the offer is particularly obscure. There is at least an analogy with partnership law[20] (albeit that one should not press the analogy too far[21]). Such an analogy may be natural in cases of quasi-partnerships, but it is not confined to such companies. In partnership law, when a partner petitions for the winding-up of the partnership, the court may instead order that that partner's share be bought by the remaining partners.[22] Even in cases of quasi-partnerships, the courts have emphasised the importance of

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[18] For example, *Re Copeland v Craddock Ltd* [1997] BCC 294.

[19] *O'Neill*, n 2 above, 1105H; cf R. Hollington, *Hollington on Shareholders' Rights* (London: Sweet & Maxwell, 8th ed, 2017), paragraphs 8-72 to 8-73 and 8-80.

[20] See further Hollington, n 19 above, 8-76.

[21] *O'Neill*, n 2 above, 1104H.

[22] *CVC/Opportunity Equity Partners Ltd v Demarco Almeida* [2002] 2 BCLC 108 at [41]-[42] (this case makes the analogy with partnership law in respect of a petition for winding-up on the just and equitable ground, but the same analogy applies in respect of unfair-prejudice petitions).

a shareholder being able to '*take out his stake and go elsewhere*'.[23] Thus, the wronged shareholder has—at most—a right to exit the company at a fair price. If the petitioner has refused an offer in such terms, the court may dismiss the petition for unreasonable refusal of an alternative remedy.[24]

In subsequent case law, the distinction between the procedural and substantive effect of reasonable offers has remained blurred. Those cases do not so much develop the principle as provide examples of its application. Usually, they follow Lord Hoffmann's guidelines in *O'Neill* with little elaboration. Even the textbooks that address the principle do so mainly in chapters on remedies or procedure, rather than liability.[25]

The following quotations illustrate the extent of the courts' previous approach to the three bases of Dr Potamianos' challenge. As to fixed-price offers:

> [After referring to Lord Hoffmann's guidance in *O'Neill v Phillips*:] In essence the defendant must have offered to purchase the shareholding at a fair value to be determined, if not agreed, by a competent expert (acting as expert not arbitrator). An offer of a particular sum, such as the £138k put forward by Mr Cooke on 31 May 2005, does not therefore suffice for this purpose, though it may have significance in relation to an award of costs at the end of the proceedings.[26]

As to non-binding offers:

> Critically, however, the opening words of the offer stated that it was 'subject to affordability'. The underlying rationale of *O'Neill v Philips* on this point is that by accepting the offer the petitioner would obtain the same result in effect as by pursuing the litigation to a successful outcome, namely an obligation imposed on the defendant to purchase the shares at a fair value, but created by contract rather than court order. By making the offer conditional on affordability the defendants destroyed that equivalence,

[23] *In re Westbourne Galleries Ltd* [1973] AC 360, 379E-G (Lord Wilberforce), paraphrased in *O'Neill*, n 2 above, 1102F-G.

[24] Cf Insolvency Act 1986, s 125(2) (again dealing with winding-up on the just and equitable ground).

[25] Hollington, n 19 above, 8-72 to 8-104; Joffe, n 11 above, 8.115 to 8.128 and 8.156 to 8.159.

[26] *Re Flex Associates*, n 8 above, [72].

> since at the end of the process the defendants would have had no obligation to buy at all, let alone at the price fixed by the expert. It would not therefore have entitled the defendants to have the petition struck out, and would not now have provided a defence to the claim based on exclusion, if it were otherwise sound.[27]

And as to offers predating the conduct complained of:

> This offer pre-dates by some years the unfairly prejudicial conduct which I have held to be established. It cannot be relied on as a remedy for conduct yet to occur. Mr Malik [the offeror] appears to think that such an offer gives him carte blanche to behave in the future as he wishes.[28]

THE INTEGRATED APPROACH OF THE COURT OF APPEAL

In *Prescott*, the Court of Appeal disagreed with the judge that the consideration of reasonable offers is a '*logically antecedent question*'. Instead, it took an integrated approach, holding that '*the factors that indicate the reasonableness or otherwise of the offer will often be closely bound up with the behaviour that is alleged to be unfairly prejudicial*'.[29] Moreover, there is no one factor that necessarily makes an offer reasonable or unreasonable.[30]

Thus, no shortcut exists in the assessment, lest it undermine the flexibility of the unfair-prejudice jurisdiction. One might consider whether the offer is reasonable, or its refusal unreasonable, but the ultimate question is always whether the conduct complained of is unfairly prejudicial in light of the offer.

The Court did, however, accept that three factors would be relevant in most cases. These were the factors that allowed the Court to determine that Mr Prescott's offers were not reasonable.

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[27] *Re Flex Associates*, n 8 above, [74].

[28] *Re Woven Rugs Ltd* [2010] EWHC 230 (Ch) at [166] (David Richards J).

[29] n 1 above, [130].

[30] n 1 above, [137].

The first factor is the value offered and its justification.[31] An offer based on an expert determination is more likely to be fair than a fixed-price offer; but a fixed-price offer based on recent approaches by third-party buyers might also be fair. Importantly, the petitioner should be able to satisfy himself that the price offered is reasonable. It is irrelevant if the offer can later be shown (for example, in court) to have been fair. Instead, the petitioner or the independent expert must have access to the company's books in order to make the assessment. Further, the petitioner needs time to assess the offer and a 'take it or leave it' offer with a short expiry may not allow this. Finally, the offer may have to give the petitioner the benefit of the doubt as to the matters complained of; for example, the price might have to take account of any alleged misapplication of company assets.

These considerations led to Mr Prescott's last two offers being found to have been unreasonable.[32] One was a proposal for an expert valuation on the basis that Dr Potamianos's allegations of unfairly prejudicial conduct were unfounded; the other was a fixed-price offer put forward with no explanation and allowing only 21 days for acceptance (most of which time was taken up dealing with board meetings to remove Dr Potamianos as a director).

The second factor is the likelihood of implementation.[33] Previous cases dealt with one aspect of this, namely affordability by the offeror.[34] If there is no realistic prospect of the offer being implemented, then the offer is not reasonable. But, conversely, there is no requirement that the offer should be legally binding (as opposed to a settlement proposal or an offer 'subject to contract').

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[31] n 1 above, [131]-[133].

[32] n 1 above, [142]-[143].

[33] n 1 above, [134]-[135].

[34] *Re Flex Associates Ltd*, n 8 above, quoted in the text at n 27 above; *West v Blanchet* [2000] 1 BCLC 795, 803c-d (Peter Leaver QC).

This factor led to Mr Prescott's first two offers being found to have been unreasonable.[35] His ability to fund the £1.34 million price was in doubt.

The third factor is the proximity of the offer to the unfairly prejudicial conduct.[36] The offer is less likely to be reasonable if it is made early in the dispute (or if there is a prospect of a sale to a third-party buyer). This explains the comment in a previous case that an offer would not give the offeror '*carte blanche to behave in future as he wishes*'.[37] But there is no strict principle that an offer cannot remedy unfairly prejudicial conduct that has yet to happen. It may be that if the offer is made at a late stage in the dispute, the petitioner should concede that the dispute is intractable and allow himself to be bought out.

This factor provided another reason why Mr Prescott's first two offers were unreasonable. In particular, at that early stage there was a possibility that Dr Potamianos would buy out Mr Prescott, or that a third-party buyer would intervene.

The Court commented on two further matters. As to expert evidence, it said that there will be many cases in which expert evidence is not required in order to assess the reasonableness of the offers; but any such evidence that is required should be available at the trial of liability.[38]

As to remedy, it said that the effect (if any) of an offer is not necessarily to defeat an unfair-prejudice petition.[39] '*The court should bear in mind the potentially draconian effect of that conclusion if the petitioner is then forced indefinitely to remain a minority shareholder in a business in the management of which he is no longer involved.*' The alternatives are firstly to

[35] n 1 above, [141].

[36] n 1 above, [136].

[37] *Re Woven Rugs*, n 28 above, and quoted in the text there; cf *Harborne Road Nominees Ltd v Karvaski* [2011] EWHC 2214 (Ch), [2012] 2 BCLC 420 at [34] (HHJ David Cooke).

[38] n 1 above, [138].

[39] n 1 above, [139].

award a remedy in the terms of the offer, perhaps subject to adjustments, and secondly to treat the offer as relevant to costs.

THE FUTURE APPLICATION OF THE COURT OF APPEAL'S APPROACH

The Court of Appeal's approach puts the emphasis firmly on the substantive effect of a reasonable offer. There is no need for equivalence between the offer and the remedy prospectively available in court (contrary to the approach in one previous case[40]). Thus, an offer can be unreasonable even if it includes everything ultimately awarded in court, perhaps because the petitioner was not allowed the opportunity to satisfy himself that the price was fair. Conversely, an offer can be reasonable if it excludes something available in court, such as a legally binding outcome.

The Court has therefore shown more clearly where the considerations lie, and has perhaps disentangled them from the procedural effect of an offer. It has also addressed difficulties such as the harshness of dismissing a petition after the offer that was meant to provide the alternative remedy has expired.

But further difficulties remain. In *O'Neill*, Lord Hoffmann stressed the importance of principles, rather than an indefinite notion of fairness, in order to promote certainty:

> …this does not mean that the court can do whatever the individual judge happens to think fair. The concept of fairness must be applied judicially and the content which it is given by the courts must be based upon rational principles. As Warner J. said in *In re J. E. Cade & Son Ltd.* [1992] B.C.L.C. 213, 227: '*The court . . . has a very wide discretion, but it does not sit under a palm tree.*'[41]

[40] *Re Flex Associates*, quoted in the text at n 27 above.

[41] n 2 above, 1098E.

Hence His Lordship's comment that '*[i]t is highly desirable that lawyers should be able to advise their clients whether or not a petition is likely to succeed*'[42] and his observation of the '*great practical importance*'[43] of setting out what counts as a reasonable offer.

Of course, the Court of Appeal in *Prescott* has introduced rational principles, in particular by identifying three factors that are likely to be relevant in most cases of reasonable offers. But its approach is to consider both the offers and the conduct complained of in the round.

As a result, it may indeed be difficult for lawyers to advise whether an offer is likely to defeat a petition. It may also be difficult to advise on how to formulate, and whether to accept, an offer. In many cases, a lawyer will only be able to say that the answer depends on how the court weighs the various factors.

In practice, these difficulties will affect the offeree more than the offeror. The offeror ought to be able to formulate a reasonable offer, if desired, by complying with Lord Hoffmann's guidelines. Even if the offer, however formulated, is not found reasonable, the offeror has another chance to defeat the petition by arguing that there was no unfair prejudice in any event. Thus, while the Court of Appeal's approach was generally favourable to petitioners (as on the facts of *Prescott* itself), they could still face significant obstacles.

Take an example. A shareholder receives an offer in response to his pre-action complaint of unfair prejudice. He does not know what unfairly prejudicial conduct is yet to come. The offeror may threaten specific consequences, but may equally desist if advised that such conduct would be unlawful under the unfair-prejudice jurisdiction. The offeree also does not know what approach the court will take if he allows the offer to expire. The court may even leave him trapped as a shareholder in the company, with no remedy. Usually, he will be a

[42] n 2 above, 1099G.

[43] n 2 above, 1106A.

minority shareholder and so be in a weak position. He may wish to avoid the risk of the offer being found to have been reasonable, and therefore sell to an oppressive majority shareholder for less than fair value.

A further example is a non-binding offer. The offeree would not know how far to pursue the offer, to test the offeror's willingness and ability to implement it, before she could reject it. No doubt the offeror would maintain that funding was available, that the documentation would be settled imminently, and so on; and meanwhile the offeree would be hamstrung.

A final example is an offer at a fixed price, based on an approach by a third party. Here, there would be little assurance that the price is fair, whereas an expert valuation or a court process would provide that assurance. Indeed, the offeror as an insider is likely to know the company's value better than the third-party buyer.

Now, similar uncertainties arise in respect of unfair-prejudice petitions in general. The reason Lord Hoffmann chose to focus on reasonable offers is, one imagines, because they can provide a shortcut to resolution and thereby prevent the dispute reaching court. If it requires an extensive investigation of the facts to decide whether an offer is reasonable, then such disputes are more likely to end up in court. Lord Hoffmann's guidance sets out when an offer is *plainly* reasonable. It is regrettable, but perhaps inevitable, that the Court of Appeal was unable to give such clear guidance for cases that are less plain.