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Derivative Claims Demystified: A Practical Guide

I. Introduction

Derivative claims empower shareholders to act where the company itself will not – usually because those in control are the alleged wrongdoers. By 'stepping into the company's shoes', shareholders can seek relief for a wrong done to the company, by its directors and, in certain circumstances, also other third parties. While historically rare, derivative claims have become a sophisticated and powerful corporate litigation tool for enforcing directors' duties and addressing governance failures.

The modern use of derivative claims reflects a broader shift in shareholder activism and corporate accountability. Recent years have seen these claims deployed not only in the context of classic boardroom disputes but also in environmental, social, and governance (**ESG**) contexts and fraud cases. From *ClientEarth v Shell*,[1] where shareholders sought to require their companies to enforce ESG-related policies, to *Hamblin v Moorwand Ltd*,[2] where a derivative claim was successfully used to recover funds lost through authorised push-payment (**APP**) fraud, the derivative claims regime has evolved to adapt to complex, modern scenarios.

For directors, this evolution carries clear implications, exposing board decisions to heightened scrutiny. For shareholders, including institutional investors, derivative claims represent a potent governance and risk-management tool. Below, we consider key legal principles underpinning the derivative claims regime in England, discuss recent illustrative cases, and outline practical and strategic considerations for stakeholders to bear in mind.

1 [2023] EWHC 1137 (Ch)
2 [2025] EWHC 817 (Ch)

II. The Legal Foundations

a. The rule in Foss v Harbottle

The starting point remains the rule expressed in the case of *Foss v Harbottle*.[3] The rule is simple: where a wrong is done to the company, the company itself is the proper claimant. Courts will not interfere in matters of internal management at the suit of an individual shareholder.

Two principles underpin the rule: (1) the company's separate legal personality, and (2) the majority rule principle. The will of the majority, acting through the board or in general meeting, binds the company, and the court will not substitute its own view if the majority chooses not to litigate.

However, the law has long recognised exceptions. Where the alleged wrongdoers control the company and block any independent decision to sue, the 'fraud on the minority' exception permits a shareholder to bring proceedings on behalf of the company. Other exceptions historically included *ultra vires* acts,[4] and acts requiring a special majority.[5]

Derivative claims at common law were, accordingly, rooted in a response to the abuse of control. Yet, the doctrine was technically complex and procedurally uncertain. This prompted reform.[6]

b. Statutory derivative claims under the Companies Act 2006

Part 11 of the Companies Act 2006 (**CA 2006** or the **Act**) modernised and codified the derivative claims regime. Section 260(1) defines a derivative claim as one brought by a member of a company "*in respect of a cause of action vested in the company"* and *"seeking relief on [its] behalf*". The claim must be brought in respect of a cause of action arising from an actual or proposed act or omission by a director involving negligence, default, breach of duty or breach of trust.[7]

Key features of the statutory regime are as follows:

- **Standing:** Any member of the company may bring a derivative claim, regardless of when they acquired their shares.[8]
- **Scope:** Claims can allege breaches of the statutory general duties – most notably the duty to promote the success of the company (s.172), to exercise reasonable care, skill and diligence (s.174), and to avoid conflicts of interest (s.175).
- **Defendants:** The claim can be brought against directors, shadow directors, former directors,[9] or third parties[10] such as accessories for dishonest assistance or knowing receipt.[11]

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[3] *Foss v Harbottle* [1843] 2 Hare 461. Two minority shareholders alleged that the company's directors had misapplied corporate assets and engaged in misconduct. They sought declarations that the directors were accountable for the company's losses and applied for the appointment of a receiver. The court refused the claim, holding that any such wrongdoing was a wrong to the company itself, not to its shareholders.

[4] Acts beyond the company's powers, which cannot be ratified.

[5] A minority shareholder can sue where the company approves by a simple majority an act which requires a special majority.

[6] The Law Commission of the United Kingdom recommended "*that there should be a new derivative procedure with more modern, flexible and accessible criteria for determining whether a shareholder can pursue the action*": Law Commission, Shareholder Remedies: Report on a Reference under Section 3(1)(e) of the Law Commissions Act 1965 (Law Com No. 246, 1997), para. 6.15.

[7] S. 260(3)

[8] S. 260(5)(c) and 260(4)

[9] S. 260(5)(a), (b)

[10] S. 260(3)

[11] *Iesini v Westrip Holdings Ltd* [2009] EWHC 2526 (Ch)

- **Relief:** The court can award any relief the company could have obtained – such as damages, injunctions, restitution or declarations.
- **Ratified breaches excluded:** Claims cannot be brought in respect of a ratified breach of duty, but votes of the director in breach (if also shareholder), and shareholders connected with that director, are to be disregarded.[12]

The Act thus widened access to the remedy but imposed rigorous permission hurdles to deter tactical litigation, as discussed below.

c. Common law, double, and multiple derivative claims

While the statutory regime governs most UK companies, common law rules continue to apply to entities outside the Act's scope. These include LLPs, trusts and foreign companies.

Further, 'double' or 'multiple' derivative claims, which arise when a shareholder of a parent company seeks to vindicate a wrong done to a subsidiary or its subsidiary controlled by the alleged wrongdoers, must also be brought at common law.

In *McGoughey*,[13] the court reaffirmed that, in order to pursue a common law derivative claim, the claimant is required to demonstrate a *prima facie* case on the merits, and 'wrongdoer control' preventing the company from suing. The latter is not limited to circumstances where the defendants have voting control over the company, and includes split votes at board level thus giving the alleged wrongdoers 'negative control'[14] and, at shareholder level, blocking or equal votes preventing authorisation of a claim.[15]

III. Requirement for the Court's Permission

A defining feature of the statutory regime is the requirement for the court's permission before a derivative claim can proceed. This two-stage filter protects companies from vexatious claims, while ensuring meritorious ones are not stifled.

Stage 1 — *Prima facie* case

At this preliminary, paper-only stage, the claimant must establish a *prima facie* case that would justify relief if the claim is unopposed. The court must be satisfied that there is a *prima facie* case that the company has a good cause of action, and that it arises out of a specified wrong (such as director's breach of duty).[16] The court examines the application and supporting evidence without hearing from the defendants or the company.[17] If the case is insufficient on its face, permission is refused outright.

Stage 2 — Inter partes hearing

[12] S. 263(2), 239(4)
[13] *McGaughey v Universities Superannuation Scheme Ltd* [2023] EWCA Civ 873
[14] *Bhullar v Bhullar* [2015] EWHC 1943 (Ch)
[15] *Abouraya v Sigmund* [2014] EWHC 277 (Ch)
[16] *Iesini v Westrip Holdings Ltd* [2009] EWHC 2526 (Ch)
[17] In *ClientEarth*, Shell was permitted to intervene at first stage, but as Trower J explained at [23], the company should not intervene in the application unless it is "outside the norm".

If the claim survives Stage 1, the company (as nominal defendant) and other defendants – typically, company directors – are served with the claim and heard. The court then determines whether to grant permission, applying both mandatory and discretionary factors.

Mandatory refusal grounds (s.263(2))

Permission **must** be refused if:

- A hypothetical director, acting in accordance with s.172, would not seek to continue the claim, taking into account factors such as the strength of the claim and the company's financial position;[18] or
- The act or omission complained of has been authorised or validly ratified.

These are bright-line exclusions. If the company, acting properly, would not litigate, the claim cannot proceed.

Discretionary factors (s.263(3))

Where no mandatory bar applies, the court exercises discretion, considering:

- **Good faith**: Is the claimant genuinely pursuing benefit for the company or seeking leverage for a personal agenda?[19]
- **Company decision-making**: Has an independent board or majority of shareholders decided not to sue, and was that decision rational and informed?
- **Alternative remedies**: Would an unfair prejudice petition, contractual claim or regulatory process better achieve the same outcome?
- **Commercial practicality:** Would litigation promote the company's success, taking into account likely cost, disruption, and risk?
- **Ratifiability**: Could the alleged breach lawfully be ratified in future, making litigation pointless?

Courts have considerable latitude in applying these factors. In *Mission Capital v Sinclair*,[20] for example, permission was refused where the court concluded that a notional director was unlikely to attach much importance to the claim as the alleged damage was speculative, and it was open to the shareholders to issue an unfair prejudice petition.

The court's task is not to decide the merits but, rather, to assess whether the company's interests justify continuation of the claim.

IV. The Interplay with Unfair Prejudice Relief

Derivative claims often sit alongside petitions under s.994 CA 2006, which provide relief for conduct unfairly prejudicial to shareholders. The fundamental distinction is that a derivative

[18] *Iesini v Westrip Holdings* [2010] B.C.C. 420. The weighing of these factors will be a commercial decision, "*which the Court is ill-equipped to take, except in a clear case. … [The bar under s. 263(2), CA 2006] will [therefore] apply only where the Court is satisfied that **no** director acting in accordance with [s. 172] would seek to continue the claim*" (original emphasis).

[19] The fact that the claimant has a financial interest in bringing the claim (aside from the financial benefit that will accrue indirectly through their shareholding if the claim is successful) will not be a factor against giving of permission, provided that the pursuit of the claim will also promote the success of the company: *Iesini v Westrip Holdings* [2010] B.C.C. 420 at [119]–[121].

[20] [2008] EWHC 1339 (Ch)

claim vindicates the company's rights, whereas an unfair prejudice petition vindicates the shareholder's own interests.

Courts have repeatedly stressed that the existence of one remedy does not exclude the other. In *Hook v Sumner*,[21] the court permitted a derivative claim to continue because one of the remedies under s.994, a buy-out of the shareholder's interest, would have undermined the claimant's wish to remain a shareholder.

Strategically, therefore, claimants should evaluate which route – derivative, unfair prejudice or both – best aligns with their objectives.

V. Illustrative Cases and Emerging Themes

ClientEarth v Shell

ClientEarth, a minority shareholder in Shell, brought a derivative claim alleging that Shell's directors had breached their s.172 and s.174 duties for failing to implement a Paris-aligned climate transition plan.[22] The court refused permission, holding that balancing environmental, commercial, and strategic factors lies squarely within directors' business judgment. Further, the claimant's token interest of 27 shares and policy-driven agenda meant that the court was not satisfied that the claim was brought in good faith.

The case signals judicial reluctance to transform derivative actions into vehicles for public-policy advocacy. However, it also highlights the growing tension between ESG expectations and judicial deference to board autonomy.

Ntzegkoutanis v Kimionis

The claimant, a 50% shareholder and director, brought an unfair prejudice petition against his fellow shareholder and director alleging that he had misused company assets and unfairly excluded him from management.[23] The Court of Appeal confirmed that a petitioner may seek relief on behalf of the company within an unfair prejudice petition under s.996(2)(c), provided that the relief mirrors what the company could have obtained in a derivative action, but cautioned against using this route to bypass restrictions on bringing derivative claims in Part 11 of the Act. The judgment highlights the flexibility of the remedies but also the court's insistence on preventing abuse of process.

Hamblin v Moorwand Ltd

In *Hamblin*,[24] the claimants transferred funds to RND Global Ltd (**RND**), which held an account with Moorwand Ltd (**Moorwand**), an electronic wallet service. The funds were then transferred out by Moorwand pursuant to a payment instruction given by a fraudster posing as RND's director. The *Quincecare* duty requires banks to exercise reasonable care and skill when executing customer payment instructions. As the claimants were not Moorwand's customers, they pursued instead a derivative claim against Moorwand on behalf of RND, for which permission was given even though the claimants were not shareholders in RND. On appeal, the court found that

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21 [2015] EWHC 3820 (Ch)
22 *ClientEarth v Shell Plc* [2023] EWHC 1137 (Ch)
23 *Ntzegkoutanis v Kimionis* [2023] EWCA Civ 1480
24 *Hamblin v Moorwand Ltd* [2025] EWHC 817 (Ch)

Moorwand breached its *Quincecare* duty by failing to investigate suspicious transfers, extending derivative claims into the fintech and fraud-recovery sphere.

Chimbganda v Kundodyiwa

In *Chimbganda*,[25] permission was granted for the claimant to continue a statutory derivative claim despite parallel unfair prejudice proceedings also commenced by her. The claimant alleged that her fellow shareholder and co-director had misused company funds and diverted business opportunities. The court held that a director acting in accordance with s.172 CA 2006 might reasonably pursue the claim to protect the company's financial and regulatory interests. Relying on *Ntzegkoutanis v Kimionis*, it confirmed that overlapping proceedings may stand where pursued in good faith and where the remedies sought are distinct, subject to close case management to avoid duplication and cost.

Together, these cases illustrate the expanding reach of derivative actions, and the courts' willingness to adopt a pragmatic approach in relation to claims that genuinely seek to benefit the company, while resisting attempts to weaponise them.

VI. Procedural and Cost Considerations

The company as nominal defendant

The company must be joined as a nominal defendant to ensure it is bound by the result. The claimant must file a witness statement confirming that notice of the application has been served on the company.[26]

Costs and *Wallersteiner* order

Because derivative claims are brought for the company's benefit, courts have long recognised that claimants should not personally bear the full costs risk. Under the *Wallersteiner* principle, the court may order the company to indemnify the claimant's costs.[27]

Such orders are discretionary and depend on the claim's strength and purpose. Typically:

- Once permission is granted, the court should generally order the company to indemnify the claimant against his costs.[28]
- The court may grant "staged" indemnities – covering costs up to specific procedural milestones –until the merits of the claim are clearer.[29]
- Where there are also existing or contemplated unfair prejudice proceedings, a pre-emptive indemnity will likely be refused if the derivative claim is being deployed to strengthen the minority shareholder's position in those proceedings.[30]

[25] *Chimbganda v Kundodyiwa (Re Derivative Claim - Goodpeople Health Care Ltd)* [2025] EWHC 1543 (Ch)

[26] CPR 19.15(6)
[27] CPR 19.19
[28] Per Lewison J's obiter observations in *Iesini v Westrip Holdings Ltd* [2009] EWHC 2536
[29] *Re Milestar Ltd* [2023] EWHC 2153 (Ch)
[30] In *Leslie v Ball (Re Derivative Claim and Companies Act 2006)* [2023] EWHC 1771 (Ch), a common law derivative claim and an unfair prejudice petition were commenced simultaneously, arising out of substantially the same facts. First stage permission to continue had been granted and the full grant of permission was not opposed, but the judge refused an indemnity, which would produce a "*manifest inequality of arms*"; the claimant was seeking an immediate benefit and an exit from the association, which was "*quite sufficient to make it unjust to order a pre-emptive indemnity*".

For company boards, indemnity exposure underscores the value of early engagement. If directors can demonstrate that the claim is unnecessary or contrary to the company's interests, they may avoid adverse costs orders.

Timing, delay, and management

Derivative proceedings move slowly. The Stage 1 review alone can take a number of months, with Stage 2 hearings and subsequent case management extending timelines further. Claimants should factor this into strategy, particularly where limitation periods or parallel insolvency processes apply.

Insolvency and funding

Insolvency complicates matters but the company's insolvency does not automatically bar derivative proceedings. In *Hughes v Burley*,[31] the court refused permission not because of insolvency *per se*, but because the claimant had offered no credible plan to fund the claim. Claimants must demonstrate both resources and commitment to protect the company from costs risk.

Third-party litigation funding may be permissible.[32]

Foreign companies and cross-border issues

Where the company is incorporated abroad, the right to bring a derivative claim depends on the law of the place of incorporation.[33] Accordingly, claimants will need to consider any applicable local requirements, for example whether permission first needs to be obtained in the relevant jurisdiction.

VII. Strategic Considerations

Derivative claims are becoming an important tool in governance strategy and investor relations. For boards, they represent both a litigation risk and a governance signal. For shareholders, they provide leverage to effect change or recover value.

Governance and ESG

Derivative claims can be used to subject boards to scrutiny of how s.172 and s.174 duties are exercised in relation to climate strategy, AI oversight, diversity, and cybersecurity. Maintaining clear, contemporaneous records of deliberations – board minutes, risk assessments, and independent advice – is the best defence to allegations of breach.

Interplay with s.994 petitions

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31 [2021] EWHC 104 (Ch)

32 The recent report on litigation funding published by the Civil Justice Council's Working Group on 2 June 2025 recommends that the current self-regulation of funding in the UK be replaced with a single statutory regime requiring, at a minimum, disclosure of the existence of funding, the name of the funder and the ultimate source of the funding.

33 *Konamaneni v Rolls Royce India* [2002] 2 WLR 72

In appropriate cases, derivative and unfair prejudice remedies can be coordinated: the derivative claim vindicates company rights, while the s.994 petition secures personal relief such as a buy out or governance changes. Together, they can be used to exert pressure while preserving flexibility.

Settlement and ADR

Courts encourage early settlement discussions. Confidential settlements, sometimes involving governance reforms or undertakings rather than damages, often achieve outcomes more aligned with corporate interests than protracted litigation.

Investor optics and reputation

As *ClientEarth* demonstrates, derivative proceedings can attract publicity. For boards, an early, transparent response can therefore prevent escalation.

Risk management

Boards should periodically review D&O insurance coverage and indemnification provisions. Clear internal protocols for handling potential conflicts and independent investigation are also vital.

VIII. Derivative Claims: Practical Takeaways

For shareholders and investors

- Ensure the claim demonstrably benefits the company.
- Assemble evidence that will be required for seeking permission.
- Prepare for the two-stage permission process and its costs implications.
- Consider the company's solvency and ability to indemnify.

For boards and directors

- Maintain detailed records evidencing compliance with statutory duties, particularly s.172 and s.174.
- Establish independent committees to assess potential claims.
- Take early legal advice when shareholder grievances arise.
- Engage proactively with claimants to explore alternatives to litigation.

IX. Conclusion

Derivative claims have travelled a long way from *Foss v Harbottle*. Once a narrow exception, they now form part of a modern corporate-governance landscape.

Recent cases demonstrate the courts' willingness to entertain creative uses of the remedy, while maintaining strict control over standing and purpose. The statutory permission regime remains a robust gatekeeper: courts will permit claims that genuinely serve the company's interests but will swiftly reject those driven by personal or political motives.

For claimants, success depends on clarity of purpose, credible evidence, and strategic realism. For boards, the key lies in documentation, diligence, and transparency. As stakeholder expectations evolve, derivative claims continue to serve as a mechanism to ensure accountability, and a reminder that governance decisions must withstand not only market scrutiny, but also judicial oversight.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

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