EXHIBIT SD1

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*190 Foss v Harbottle

25 March 1843

(1843) 2 Hare 461

67 E.R. 189

1843

[461] *March* 4, 6, 7, 8, 25, 1843.

[See *Hallows* v. *Fernie* , 1867-68, L. R. 3 Eq. 532; L. R. 3 Ch. 467; *Hoole* v. *Great Western Railway Company* , 1867, L. R. 3 Ch. 274; *Seaton* v. *Grant* , 1867, 36 L. J. Ch. 642; *Clinch* v. *Financial Corporation* , 1868, L. R. 5 Eq. 482; L. R. 4 Ch. 117; *Atwool* v. *Merryweather* , 1868, L. R. 5 Eq. 467, n.; *Turquand* v. *Marshall* , 1869, L. R. 4 Ch. 386; *Gray* v. *Lewis* (No. 1), 1869-73, L. R. 8 Eq. 541; L. R. 8 Ch. 1050; *Pickering* v. *Stephenson* , 1872, L. R. 14 Eq. 339; *Menier* v. *Hooper's Telegraph Works* , 1874, L. R. 9 Ch. 353; *Ward* v. *Sittingbourne and Sheerness Railway Company* , 1874, L. R. 9 Ch. 492, n.; *Macdougall* v. *Gardiner* (No. 1), 1875, L. R. 20 Eq. 393; L. R. 10 Ch. 606; *Macdougall* v. *Gardiner* (No. 2), 1875, 1 Ch. D. 13; *Russell* v. *Wakefield Waterworks Company* , 1875, L. R. 20 Eq. 480; *Duckett* v. *Gover* , 1877, 25 W. R. 554; *Pender* v. *Lushington* , 1877, 6 Ch. D. 80; *Isle of Wight Railway Company* v. *Tahourdin* , 1883, 25 Ch. D. 333; *Studdert* v. *Grosvenor* , 1886, 33 Ch. D. 535; *La Compagnie de Mayville* v. *Whitley* [1896], 1 Ch. 807; *Tiessen* v. *Henderson* [1899], 1 Ch. 866; *Alexander* v. *Automatic Telephone Company* [1900], 2 Ch. 69; *Burland* v. *Earle* [1902], A. C. 93; *Punt* v. *Symons & Company Ltd.* [1903], 2 Ch. 516.]

Bill by two of the proprietors of shares in a company incorporated by Act of Parliament, on behalf of themselves and all other the proprietors of shares except the Defendants, ***191*** against the five directors (three of whom had become bankrupt), and against a proprietor who was not a director, and the solicitor and architect of the company, charging the Defendants with concerting and effecting various fraudulent and illegal transactions, whereby the property of the company was misapplied, aliened and wasted; that there had ceased to be a sufficient number of qualified directors to constitute a board; that the company had no clerk or office; that in such circumstances the proprietors had no power to take the property out of the hands of the Defendants, or satisfy the liabilities or wind up the affairs of the company; praying that the Defendants might be decreed to make good to the company the losses and expenses occasioned by the acts complained of; and praying the appointment of a receiver to

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take and apply the property of the company in discharge of its liabilities, and secure the surplus: the Defendants demurred.

Held, that, upon the facts stated, the continued existence of a board of directors *de facto* must be intended; that the possibility of convening a general meeting of proprietors capable of controlling the acts of the existing board was not excluded by the allegations of the bill; that in such circumstances there was nothing to prevent the company from obtaining redress in its corporate character in respect of the matters complained of; that therefore the Plaintiffs could not sue in a form of pleading which assumed the practical dissolution of the corporation; and that the demurrers must be allowed.

When the relation of trustee and *cestui que trust* begins, as between the projectors of public companies and such companies.

Some forms prescribed for the government of a corporation may be imperative, and others directory only.

On argument of a demurrer, facts not averred in the bill, and which might possibly have been denied by plea, if they had been averred, intended against the pleader.

The bill was filed in October 1842 by Richard Foss and Edward Starkie Turton, on behalf of themselves and all other the shareholders or proprietors of shares in the company called "The Victoria Park Company," except such of the same shareholders or proprietors of shares as were Defendants thereto, against Thomas Harbottle, Joseph Adshead, Henry Byrom, John Westhead, Richard Bealey, Joseph Denison, Thomas Bunting and Richard Lane; and also against H. Rotton, E. Lloyd, T. Peet, J. Biggs and S. Brooks, the several assignees of Byrom, Adshead and Westhead, who had become bankrupts.

The bill stated, in effect, that in September 1835 certain persons conceived the design of associating for the purchase of about 180 acres of land, situated in the parish of Manchester, belonging to the Defendant, Joseph Denison, and others, and of enclosing and planting the same in an ornamental and park-like manner, and erecting houses thereon with attached gardens and pleasure-grounds, and selling, letting or otherwise disposing thereof; and the Defendants, Harbottle, Adshead, Byrom, Westhead, Bealey, Denison, Bunting and Lane, agreed to form a joint stock company, to consist of themselves and others, for the said purpose: that in October 1835 **[462]** plans of the land, and a design for laying it out, were prepared; that, after the undertaking had been projected and agreed upon, Denison purchased a considerable portion of the said land of the other original owners with the object of reselling it at a profit, and Harbottle, Adshead, Byrom, Westhead, Bunting and Lane, and one P. Leicester, and

several other persons, not members of the association, purchased the said land in parcels of Denison and the other owners, so that at the time of passing the Act of Incorporation Harbottle, Adshead, Byrom, Westhead, Bunting and Lane owned more than half of the land in question, the remainder being the property of persons who were not shareholders: that Denison and the last-named five Defendants made considerable profits by reselling parts of the said land at increased chief rents before the Act was passed.

The bill stated that, between September 1835 and the beginning of 1836, various preliminary steps were taken for enabling the projectors of the said company to set it on foot: that in April 1836 advertisements, describing the objects of the proposed company and the probabilities of its profitable result, were published, in which it was proposed to form the association on the principle of a tontine: that the first eight ***192** named Defendants and several other persons subscribed for shares in the proposed company, and, among others, the Plaintiff, Foss, subscribed for two shares, and the Plaintiff, Turton, for twelve shares of £100 each, and signed the contract, and paid the deposit of £5 per share: that at a public meeting of the subscribers called in May 1836 it was resolved that the report of the provisional committee should be received, and the various suggestions therein contained be adopted, subject to the approval of the directors, who were requested to complete such purchases of land, and also such other acts as they might **[463]** consider necessary for carrying the objects of the undertaking into effect; and it also resolved that Harbottle, Adshead, Byrom, Westhead and Bealey should be appointed directors, with power to do such acts as they might consider necessary or desirable for the interests of the company; and Westhead, W. Grant and J. Lees were appointed auditors, Lane architect, and Bunting solicitor: that, in order to avoid the responsibilities of an ordinary partnership, the Defendants Harbottle and others suggested to the subscribers the propriety of applying for an Act of Incorporation, which was accordingly done: that in compliance with such application, by an Act, intituled "An Act for Establishing a Company for the Purpose of Laying Out and Maintaining an Ornamental Park within the Townships of Rusholme, Charlton-upon -Medlock and Moss Side, in the County of Lancaster," which received the Royal assent on the 5th of May 1837 (7 Will. 4), it was enacted that certain persons named in the Act, including Harbottle, Adshead, Bealey, Westhead, Bunting and Denison and others, and all and every such other persons or person, bodies or body politic, corporate or collegiate, as had already subscribed or should thereafter from time to time become subscribers or a subscriber to the said undertaking, and be duly admitted proprietors or a proprietor as thereinafter mentioned, and their respective successors, executors, administrators and assigns, should be and they were thereby united into a company for the purposes of the said Act, and should be and they were thereby declared to be one body politic and corporate by the name of "The Victoria Park Company," and by that

name should have perpetual succession and a common seal, and by that name should and might sue and be sued, plead or be impleaded, at law or in equity, and should and might prefer and prosecute any bill or bills of indictment or information against any person or **[464]** persons who should commit any felony, misdemeaour, or other offence indictable or punishable by the laws of this realm, and should also have full power and authority to purchase and hold lands, tenements and hereditaments to them, and their successors and assigns, for the use of the said undertaking, in manner thereby directed. [The bill stated several other clauses of the Act. [1]] ***193**

[465] The bill also stated the schedule annexed to the Act, whereby the different plots of the said land, numbered **[466]** from 1 to 37, were stated to have been purchased by the Victoria Park Company from the various persons whose **[467]** names were therein set forth, and including the following names:—"Mr. P. Leicester and others;" "Mr. Lacy and another;" "Mr. Lane" and "Mr. Adshead;" that **[468]** the land so stated to be purchased of "P. Leicester and others" was at the time of passing of the Act vested partly in P. Leicester, and partly in Westhead, Bunting ***194** and Byrom, and the land so stated to be purchased of "Mr. Lacy and another" was at the time of the passing of the Act vested partly in Mr. Lacey and partly in Lane.

The bill stated that the purchase and sale of the said land as aforesaid was the result of an arrangement fraudulently concerted and agreed upon between Harbottle, Adshead, Byrom, Westhead, Denison, Bunting and Lane, at or after the formation of the company was agreed upon, with the object of enabling themselves to derive a ***195** profit or personal benefit from the establishment of the said company; and that the arrangement amongst the persons who were parties to the plan was that a certain number from amongst themselves should be appointed directors, and should purchase for the company the said plots of land from the persons in whom they were vested, at greatly increased and exorbitant prices: that it was with a view to carry the arrangement into effect that Harbottle, Adshead, Byrom and Westhead procured themselves to be appointed directors, and Denison procured himself to be appointed auditor: that accordingly, after the said plots of land had become vested in the several persons named in the schedule, and before the passing of the Act, the said directors, on behalf of the company, agreed to purchase the same from the persons named in the schedule at rents or prices greatly exceeding those at which the said persons had purchased the same: that after the Act was passed Harbottle, Adshead, Byrom, Westhead and Bealey continued to act as directors of the incorporated company in the same manner as before: that Adshead continued to act as director until the 18th of July 1839, Byrom until the 2d of December 1839, and **[469]** Westhead until the 2d of January 1840, at which dates respectively fiats in bankruptcy were issued against

them, and they were respectively declared bankrupts, and ceased to be qualified to act as directors, and their offices as directors became vacated.

The bill stated that upwards of 3000 shares of £100 in the capital of the company were subscribed for: that the principle of tontine was abandoned: that before 1840 calls were made, amounting, with the deposit, to £35 per share, the whole of which were not, however, paid by all the proprietors, but that a sum exceeding £35,000 in the whole was paid.

The bill stated that, after the passing of the Act, Harbottle, Adshead, Byrom, Westhead, Bunting and Lane, with the concurrence of Denison and of Bealey, proceeded to carry into execution the design which had been formed previously to the incorporation of the company, of fraudulently profiting and enabling the other persons who had purchased and then held the said land, to profit by the establishment of the company and at its expense; and that the said directors accordingly, on behalf of the company, purchased, or agreed to purchase, from themselves, Harbottle, Adshead, Byrom and Westhead, and from Bunting and Lane, and the other persons in whom the said land was vested, the same plots of land, for estates corresponding with those purchased by and granted to the said vendors, by the original owners thereof, charged with chief or fee-farm rents, greatly exceeding the rents payable to the persons from whom the said vendors had so purchased the same: that of some of such plots the conveyances were taken to the Victoria Park Company, by its corporate name; of others, to Harbottle, Adshead, Byrom, Westhead and Bealey, as directors in trust for the company; **[470]** and others rested in agreement only, without conveyance: that by these means the company took the land, charged not only with the chief rents reserved to the original landowners, but also with additional rents, reserved and payable to Harbottle, Adshead, Byrom, Westhead, Denison, Bunting, Lane and others: that, in further pursuance of the same fraudulent design, the said directors, after purchasing the said land for the company, applied about £27,000 of the monies in their hands, belonging to the company, in the purchase or redemption of the rents so reserved to themselves, Harbottle, Adshead, Byrom, Westhead, Denison, Bunting, Lane and others, leaving the land subject only to the chief rent reserved to the original landowners.

The bill stated that the plans of the park were contrived and designed by Lane, in concert with Denison, the directors and Bunting, so as to render the formation of the park the means of greatly increasing the value of certain parcels of land, partly belonging to Denison and partly to Lane, situated on the outside of the boundary line of the park, but between such boundary line and one of the lodges and entrance gates, called Oxford Lodge and Gate, erected on a small part of the same land purchased by

the company; and through which entrance, and the land so permitted to be retained by Denison and Lane, one of the principal approaches to the park was made: that the said land so retained by Denison and Lane was essentially necessary to the establishment of the park, according to the plans prepared by Lane, and the same was virtually incorporated in the park, and houses erected thereon would enjoy ***196** all the advantages of the park, and plots thereof were in consequence sold by Denison and Lane for building land at enhanced prices.

[471] The bill stated that, after the purchase of the land as aforesaid, the directors proceeded to carry into effect the design of converting the same into a park, and they accordingly erected lodges and gates, marked out with fences the different crescents, terraces, streets and ways; formed drains and sewers, and made roadways, and planted ornamental trees and shrubs; that they also caused to be erected in different parts of the park several houses and buildings, some of which only were completed; and that the directors alleged the monies expended in the roads, drains and sewers amounted to £12,000, and in the houses and buildings to £39,000, or thereabouts: that the said directors sold and let several plots of land, and also sold and let several of the houses and buildings, and received the rents and purchase-money of the same.

The bill stated that Harbottle, Denison, Bunting and Lane did not pay up their calls, but some of them retained part, and others the whole thereof; Harbottle and Lane claiming to set off the amount of the calls against the chief rents of the lands which they sold to the company, Bunting claiming to set off the same against the chief rents, and the costs and charges due to him from the company; and Denison claiming to set off the amount of the calls against the rents payable to him out of the land which he sold to persons who resold the same to the company.

The bill stated that owing to the large sums retained out of the calls, the sums appropriated by the said directors to themselves, and paid to others in reduction of the increased chief rents, and payment of such rents, and owing to their having otherwise wasted and misapplied a considerable part of the monies belonging to the company, the funds of the company which came **[472]** to their hands shortly after its establishment were exhausted: that the said directors, with the privity, knowledge and concurrence of Denison, Bunting and Lane, borrowed large sums of money from their bankers upon the credit of the company: that, as a further means of raising money, the said directors, and Bunting and Lane, with the concurrence of Denison, drew, made and negotiated various bills of exchange and promissory notes; and that the said directors also caused several bonds to be executed under the corporate seal of the company for securing several sums of money to the obligees thereof: that by the middle or latter part of the year 1839 the directors, and Bunting and Lane, had come

under very heavy liabilities; the chief rents payable by the company were greatly in arrear, and the board of directors, with the concurrence of Denison, Bunting and Lane, applied to the United Kingdom Life Assurance Company to advance the Victoria Park Company a large sum of money by way of mortgage of the lands and hereditaments comprised in the park; but the Assurance Company were advised that the Victoria Park Company were, by the 90th section of their Act, precluded from borrowing money on mortgage, until one-half of their capital (namely £500,000) had been paid up, and on that ground declined to make the required loan: that the directors, finding it impossible to raise money by mortgage in a legitimate manner, resorted to several contrivances for the purpose of evading the provisions of the Act, and raising money on mortgage of the property of the company, by which means several large sums of money had been charged by way of mortgage or lien upon the same: that to effect such mortgages or charges, the directors procured the persons who had contracted to sells plots of land to the company, but had not executed conveyances, to convey the same, by the direction of the board, to some **[473]** other person or persons in mortgage, and afterwards to convey the equity of redemption to the directors in trust for the company: that the directors also conveyed some of the plots of land which had been conveyed to them in trust for the company to some other persons by way of mortgage, and stood possessed of the equity of redemption in trust for the company: that, for the same purpose, the board of directors caused the common seal of the company to be affixed to several conveyances of plots of land which had been conveyed to the company by their corporate name, and to the directors in trust for the company, whereby the said plots of land were expressed to be conveyed for a pretended valuable consideration to one or more of the said directors absolutely, and the said directors or director then conveyed the same to other persons on mortgage to secure sometimes ***197** monies advanced to the said directors, and by them paid over to the board in satisfaction of the consideration monies expressed to be paid for the said prior conveyances under the common seal, sometimes antecedent debts in respect of monies borrowed by the board, and sometimes monies which had been advanced by the mortgagees upon the security of the bills and notes which had been made or discounted as aforesaid: that, in other cases, the said directors and Bunting deposited the title-deeds of parcels of the land and buildings of the company with the holders of such bills and notes to secure the repayment of the monies due thereon, and in order to relieve the parties thereto: that, by the means aforesaid, the directors, with the concurrence of Denison, Bunting and Lane, mortgaged, charged or otherwise incumbered the greater part of the property of the company: that many of such mortgagees and incumbrancers had notice that the said board of directors had not power under the Act to mortgage or charge the property of the company, and that the **[474]** said mortgages, charges and incumbrances were fraudulent and void as against the company, but that the

Defendants allege that some of the said incumbrances were so planned and contrived that the persons in whose favour they were created had not such notice.

That the said directors having exhausted every means which suggested themselves to them of raising money upon credit, or upon the security of the property and effects of the company, and being unable by those means to provide for the whole of the monies due to the holders of the said bills and notes, and the other persons to whom the said directors in the said transactions had become indebted as individuals, and to satisfy the debts which were due to the persons in whose favour the said mortgages and incumbrances had been improperly created, and in order to release themselves from the responsibility which they had personally incurred by taking conveyances or demises of parts of the said land to the said directors as individuals in trust for the company, containing covenants on their parts for payment of the reserved rents, the said directors resolved to convey and dispose of the property of the company, and they accordingly themselves executed and caused to be executed under the common seal of the company, divers conveyances, assignments and other assurances, whereby divers parts of the said lands and effects of the company were expressed to be conveyed or otherwise assured absolutely to the holders of some of the said bills and notes, and some of the said mortgagees and incumbrancers, in consideration of the monies thereby purported to be secured; and also executed, and caused to be executed under the common seal of the company, divers conveyances and assurances of other parts of the said lands to the persons who sold the same to the company, in consideration of their releasing them from **[475]** the payment of the rents reserved and payable out of the said lands: that many of such conveyances had been executed by Harbottle, Adshead, Westhead and Bealey, and a few by Byrom, who had been induced to execute them by being threatened with suits for the reserved rents: that Harbottle, Adshead, Byrom, Westhead and Bealey threatened and intended to convey and assure the remaining parcels of land belonging to the company to the holders of others of the said bills and notes, and to others of the said mortgagees and incumbrancers and owners of the chief rents, in satisfaction and discharge of the said monies and rents due and to become due to them respectively.

The bill stated that, upon the bankruptcy of Byrom, Adshead and Westhead, their shares in the company became vested in the Defendants, their assignees, and that they (the bankrupts) had long since ceased to be, and were not, shareholders in the company: that the whole of the land resold by them was vested in some persons unknown to the Plaintiffs, but whose names the Defendants knew and refused to discover: that, upon the bankruptcy of Westhead, there ceased to be a sufficient number of directors of the company to constitute a board for transacting the business of the company in manner provided by the Act, and Harbottle and Bealey became the

only remaining directors whose office had not become vacated, and no person or persons had been appointed to supply the vacancies in the board of directors occasioned by such bankruptcies, and consequently there never had been a properly constituted board of directors of the company since the bankruptcy of Westhead.

That Byrom, Adshead and Westhead, nevertheless, after their respective bankruptcies, executed the several **[476]** absolute conveyances ond other assurances of the lands and property of the company, which were so executed for the purposes and in ***198** manner aforesaid, after the directors had exhausted their means of raising money upon credit or upon the security of the property of the company.

That about the end of the year 1839, or commencement of the year 1840, the said directors discharged Brammell, the secretary of the company, and gave up the office taken by the company in Manchester, and transferred the whole or the greater part of the title-deeds, books and papers of the said company into the hands of Bunting; and from that time to the present the company had had no office of its own, but the affairs of the company had been principally conducted at the office of Bunting.

That the only parts of the land bought by the company which had not been conveyed away either absolutely or by way or mortgage, and the only part of the other property and effects of the company which had not been disposed of and made away with in manner aforesaid, remained vested in, and in the order and disposition of, Harbottle, Adshead, Byrom, Westhead, Bealey and Bunting, in whose custody or power the greater part of the books, deeds and papers belonging to the company which had not been made away with remained: that by the fraudulent acts and proceedings in the premises to which Harbottle, Adshead, Byrom, Westhead, Bealey and Bunting were parties, the property and effects of the said company had been and then were involved in almost inextricable difficulties, and if such property and effects were any longer allowed to remain in their order and disposition, the same would be in danger of being wholly dissipated and irretrievably **[477]** lost: that the said company were then largely indebted to their bankers and other persons who had *bonâ fide* advanced money to the company, and to the builders and other persons who had executed some of the works in the park, and provided materials for the same; while, in consequence of the property of the company having been wasted and improperly disposed of by the directors, there were at present no available funds which could be applied in satisfaction of the debts of the company, and that some of the creditors of the said company had obtained judgments in actions at law brought by them against the company for the amount of their debts, on which judgments interest was daily accumulating.

The bill stated that in the present circumstances of the company, and the board of directors thereof, the proprietors of shares had no power to take the property and effects of the company out of the hands of Harbottle, Adshead, Byron, Westhead, Bealey and Bunting, and they had no power to appoint directors to supply the vacancies in the board occasioned by the said bankruptcies, and the proprietors of shares in the company had no power to wind up, liquidate or settle the accounts, debts or affairs of the company, or to dissolve the company, nor had they any power to provide for and satisfy the existing engagements and liabilities of the company with a view to its continuance, and the prosecution of the undertaking for which it was established without the assistance of the Court: that if a proper person were appointed by the Court to take possession of and manage the property and effects of the company, and if the company were to be repaid the amount of all losses and expenses which it had sustained or incurred by reason of the fraudulent and improper acts and proceedings of the Defendants in the premises, and **[478]** which the Defendants, or any of them, were liable to make good to the said company, as thereinafter prayed; and if the company were decreed to take and have conveyed to them so much of the said land which was retained by Denison and Lane as aforesaid, upon paying or accounting to them for the fair value thereof at the time when the undertaking was first projected; and Denison and Lane were to pay or account to the said company for the price received by them for so much of the same land as had been sold by them, over and above what was the fair price for the same at the time the undertaking was first projected; and if the mortgages, charges, incumbrances and liens, and the said conveyances and other assurances, by means of which the property and effects of the company had been improperly incumbered and disposed of, which could be redeemed or avoided, as against the persons claiming thereunder, were redeemed and set aside, and the property and effects of the company thereby affected were restored to it, and the Defendants, who had not become bankrupt, and who had not paid up, but ought to have paid up, into the joint stock capital of the company, the amounts of the several calls made by the directors on their respective shares, were to pay up the same, the lands, property and effects of the company would not only be ***199** sufficient to satisfy the whole of its existing debts and liabilities, but leave a surplus, which would enable the company to proceed with, and either wholly or in part accomplish, the undertaking for which it was incorporated.

The bill stated that the Defendants concealed from the Plaintiffs, and the other shareholders in the company, who were not personally parties thereto, the several fraudulent and improper acts and proceedings of the said directors and the said other Defendants, and **[479]** the Plaintiffs and the other shareholders had only recently ascertained the particulars thereof, so far as they were therein stated, and they were

unable to set forth the same more particularly, the Defendants having refused to make any discovery thereof, or to allow the Plaintiffs to inspect the books, accounts or papers of the company.

The bill charged that Harbottle and Bealey, and the estates of Adshead, Byrom and Westhead, in respect of that which occurred before their said bankruptcies, and Adshead, Byrom and Westhead, as to what occurred since their said bankruptcies, were liable to refund and make good to the company the amount of the losses and expenses which it had sustained in respect of the fraudulent and improper dealings of the said directors of the company with its lands and property: that Denison, Bunting and Lane had counselled and advised the directors in their said proceedings, and had derived considerable personal benefit and advantage therefrom: that Denison, Bunting and Lane were all parties to the said fraudulent scheme planned and executed as aforesaid, by which the several plots or parcels of land in the park were purchased and resold to the said company at a profit and at a price considerably exceeding the real value of the same, and that Denison, Bunting and Lane had derived considerable profit from the increased price or chief rents made payable out of the several plots or parcels of land which were purchased and resold by them in manner aforesaid, and from the monies which were paid to them as a consideration for the reduction of the same chief rents as before mentioned.

The bill charged that several general meetings, and extraordinary general meetings, and other meetings of **[480]** the shareholders of the company, were duly convened and held at divers times, between the time when the company was first established and the year 1841, and particularly on or about the several days or times thereinafter mentioned (naming ten different dates, from July 1837 to December 1839), and that at such meetings false and delusive statements respecting the circumstances and prospects of the company were made by the directors to the proprietors who attended such meetings, and the truth of the several fraudulent and improper acts and proceedings therein complained of was not disclosed.

The bill charged that, under the circumstances, Denison, Bunting and Lane, having participated in and personally benefited by and concealed from the other shareholders the several fraudulent and improper acts aforesaid, were all jointly and severally liable together, with the said directors, to make good to the company the amount of the losses and expenses which had been or might be incurred in consequence of such of the said wrongful and fraudulent acts and proceedings as they were parties or privies to: that Harbottle, Byrom, Adshead, Westhead and Bealey, respectively, had still some of the property and effects belonging to the company: that the said last-named Defendants had not paid up the calls due and payable on their respective shares: that

the Plaintiffs had as yet paid only three of the calls on their shares, not having paid the remainder in consequence of learning that, owing to some misconduct of the directors, the affairs of the company were in difficulties, the cause of which difficulties the Plaintiffs had but lately, and with considerable difficulty, ascertained to have arisen from the proceedings aforesaid, but in all other respects the Plaintiffs had conformed to the provisions of the Act: that there were not any **[481]** shareholders in the company who had not paid up the calls on their shares besides the Plaintiffs and the said Defendants: that the names and places of abode of the other persons who are not shareholders in the company, but are interested in or liable in respect of any of the said matters, were unknown to the Plaintiffs, and the Defendants ought to discover the same: that the number of shareholders in the company was so great, and their rights and liabilities were so subject to change and fluctuation, by death and otherwise, that it would be impossible to prosecute the suit with effect if they were all made parties thereto. ***200***

The bill charged that Bunting claimed a lien upon the documents in his possession belonging to the company for the costs of business done by him as the attorney of the company, but a great part of such business consisted of the fraudulent acts aforesaid; and that he had received out of the funds of the company divers large sums of money exceeding the amount properly due to him: that Bunting had deposited some of the deeds belonging to the company with certain bankers at Liverpool, and, among the rest, the contract executed by the Plaintiffs and the other shareholders before the Act was passed, as a security for the payment of a bill of exchange for £3000, to which Bunting was individually a party, but for which he untruly pretended that the company was responsible; and that the holders of such deeds threatened to sue the Plaintiffs for the said £3000, as parties to the contract, on the ground that the capital was not paid up; and also that the said directors threatened to cause actions at law to be brought against the Plaintiffs, under the powers of the Act, in the name of Harbottle or Bealey, as the nominal Plaintiff on behalf of the company, for the amount of the unpaid calls on their shares.

[482] The bill charged that Harbottle and Bealey were two directors of the company, but they respectively refused to use or allow either of their names to be used as the nominal Plaintiffs in this suit on behalf of the company; but that Harbottle was a necessary party, not only in respect of his liability, but also as a nominal Defendant on behalf of the company.

After various charges, recapitulating in terms the alleged title of the Plaintiffs to the relief and discovery sought by the prayer, the bill prayed that an account might be taken of all monies received by the Defendants, Harbottle, Adshead, Byrom, Westhead,

Bealey, Denison and Lane, or any of them, for the use of the company, or which but for their wilful default might have been received, and of the application thereof; also an account of the losses and expenses incurred in consequence of the said fraudulent and improper dealings of the Defendants with the monies, lands and property of the company which they or any of them were liable to make good, and that they might be respectively decreed to make good the same, including in particular the profits made by Harbottle, Denison, Bunting and Lane, by buying and reselling the said land, and the profits made by Denison and Lane out of the said land retained by them; and that Denison and Lane might be decreed to convey the residue of the said land to the company, upon payment of the fair value thereof at the time the undertaking was projected: that it might be declared that the said mortgages, charges, incumbrances and liens upon the lands and property created as aforesaid, so far as regards the Defendants who executed the same or were privy thereto, were created fraudulently and in violation of the provisions of the Act, and that Harbottle, Bealey, Denison, Bunting and Lane might be decreed to make good to the company the principal **[483]** money and interest due and owing upon security of such of the mortgages, charges and liens as were still subsisting, with all costs sustained by the company in relation thereto; and that it might be declared that Harbottle, Adshead, Byrom, Westhead and Bealey, by executing the said conveyances and assurances of the lands and property of the company to the said mortgagees, holders of notes and bills and others, committed a fraudulent breach of trust, and that Harbottle, Adshead, Byrom, Westhead, Bealey, Denison, Bunting and Lane might be decreed to make good to the company the purchase-money and rents paid by the company for such lands, and expended in building and improving the same, with interest and expenses; and that the monies so recovered from the Defendants might be applied in redeeming and repurchasing the said lands and restoring them to the company. And that inquiries might be directed to ascertain which of the mortgages and incumbrances, and of the conveyances and assurances, of the lands and property of the company could be avoided and set aside as against the persons claiming the benefit thereof, and that proceedings might be taken for avoiding them accordingly. And that an account might be taken of all the property and effects of the company, and the unpaid calls sued for and recovered, and that a sufficient part of such property might be applied in liquidating the existing debts and liabilities of the company, and the residue secured for its benefit. And that, for the purposes aforesaid, a receiver might be appointed to take possession of, recover and get in the lands, property and effects of the company, and for that purpose to sue in ***201*** the names of Harbottle and Bealey, or otherwise, as occasion might require; and that Harbottle, Adshead, Byrom, Westhead, Bealey and Bunting might be decreed to deliver up to **[484]** such receiver the property, effects, deeds, muniments and documents belonging to the company. And that the same Defendants might be

restrained by injunction from holding, receiving or intermeddling with the property and effects of the company, and from executing, or causing to be executed, under the common seal of the company, any deed or instrument conveying, assigning or disposing of the same. And that Harbottle, Denison, Bunting and Lane might be restrained from entering or distraining upon any of the said lands sold by them to or in trust for the company as aforesaid. And the Plaintiffs thereby offered to pay into Court the amount of the unpaid calls due from them to the company.

The Defendants, Harbottle, Adshead and Westhead, demurred to the bill, assigning for cause want of equity, want of parties and multifariousness; and suggesting that all the proprietors of shares in the company, the assignees of P. Leicester, and the owners of land named in the schedule to the Act, were necessary parties. The Defendant Bealey, the Defendant Denison and the Defendants Bunting and Lane also put in three several demurrers, assigning like causes.

Mr. Lowndes and Mr. Rolt, in support of the demurrers of Harbottle, Adshead and Westhead, and of Bunting and Lane.

Mr. Walker and Mr. Glasse, in support of the demurrers of Bealey and Denison.

Mr. James Russell, Mr. Roupell and Mr. Bartrum, for the bill.

[485] On the part of the Defendants it was contended that the suit complaining of injuries to the corporation was wholly informal in having only some of its individual members, and not the corporation itself, before the Court; that this defect would not be cured by adding the corporation as parties Defendants, for the Plaintiffs were not entitled to represent the corporate body, even as distinguished from the Defendants and for the purpose of impeaching the transactions complained of; and the Plaintiff's bill could not therefore be sustained.

It was further argued that the Plaintiffs, if they had any ground for impeaching the conduct of the Defendants, might have used the name of the corporation; and, in that case, it would have been open to the Defendants, or to the body of directors or proprietors assuming the government of the company, to have applied to the Court for the stay of proceedings, or to prevent the use of the corporate name; and, upon that application, the Court would have inquired into the alleged usurpation or abuse of authority, and determined whether the Plaintiff should be permitted to proceed. Or the suit might have been in the shape of an information by the Attorney-General to correct the alleged abuse of powers granted for public purposes. The statements of fact in the bill, it was also contended, did not support the general charges of fraud upon which the title to relief was founded. Several other points of equity, as applicable to the cases

made against the several Defendants, and in respect of the suggested defects of parties, were also made, but the judgment did not turn on these points.

On the part of the Plaintiff, so far as related to the **[486]** point on which the decision proceeded, namely, their right to sustain the bill on behalf of themselves and the other shareholders against the Defendants, without regard to the corporate character of the body, it was argued that the company was not to be treated as an ordinary corporation; that it was in fact a mere partnership, having objects of private benefit, and that it must be governed by rules analogous to those which regulated partnerships or joint stock companies, consisting of numerous persons, but not incorporated. The Act of Incorporation was intended to be beneficial to the company, and to promote the undertaking, but not to extinguish any of the rights of the proprietors *inter se.* The directors were trustees for the Plaintiffs to the extent of their shares in the company; and the fact that the company had taken the form of a corporation would not be allowed to deprive the *cestui que trusts* of a remedy against their trustees for the abuse of their powers. The Act of Incorporation, moreover, expressly exempted the proprietors of the company, or persons dealing with the company, from the necessity of adopting the form of proceeding applicable to a pure corporation; for the 74th section (*supra* , p. 464, n.) enabled them to sue and be sued ***202** in the name of the treasurer, or any one of the directors for the time being: the bill alleged that the two remaining directors had refused to institute the suit, and shewed, in fact, that it would be against their personal interest to do so, inasmuch as they were answerable in respect of the transactions in question; if the Plaintiffs could not, therefore, institute the suit themselves they would be remediless. The directors were made Defendants; and, under the 74th clause of the Act, any one of the directors might be made the **[487]** nominal representative of the company; the corporation was therefore distinctly represented in the suit. The present proceeding was, in fact, the only form in which the proprietors could now impeach the conduct of the body to whom their affairs had been intrusted. The 38th section expressly excluded any proprietor, not being a director, from interfering in the management of the business of the company on any pretence whatever. The extinction of the board of directors by the bankruptcy and consequent disqualification of three of them (sect. 67), and the want of any clerk or office, effectually prevented the fulfilment of the form which the 46th, 47th and 48th sections of the Act required, in order to the due convening of a general meeting of proprietors competent to secure the remaining property of the company, and provide for its due application.

The following cases were cited during the argument:— *The Charitable Corporation* v. *Sutton* (2 Atk. 400), *Attorney-General* v. *Jackson* (11 Ves. 365), *Adley* v. *The Whitstable Company* (17 Ves. 315; 2 M. & Sel. 53; 19 Ves. 304; 1 Mer. 107, S. C.),

Blackburn v. *Jepson* (3 Swans. 138), *Hichens* v. *Congreve* (4 Russ. 562), *Blain* v. *Agar* (2 Sim. 289), *Richards* v. *Davies* (2 R. & M. 347), *Ranger* v. *Great Western Railway Company* (1 Railway Cases, 1), *Seddon* v. *Connell* (10 Sim. 58, 79), *Preston* v. *Grand Collier Dock Company* (11 Sim. 327, S. C.; 2 Railway Cases, 335), *Attorney-General* v. *Wilson* (Cr. & Ph. 1), *Wallworth* v. *Holt* (4 Myl. & Cr. 619), *Bligh* v. *Brent* (2 Y: & Coll. 295; *per* Alderson, B.), 6 Viner. Ab. 306, tit. Corporation, U., Bacon, Ab. tit. Statute, I. 2.

[488] *March* 25. THE VICE-CHANCELLOR [Sir James Wigram]. The relief which the bill in this case seeks, as against the Defendants who have demurred, is founded on several alleged grounds of complaint; of these it is only necessary that I should mention two, for the consideration of those two grounds involves the principle upon which I think all the demurrers must be determined. One ground is that the directors of the Victoria Park Company, the Defendants Harbottle, Adshead, Byrom and Bealey, have, in their character of directors, purchased their own lands of themselves for the use of the company, and have paid for them, or rather taken to themselves out of the monies of the company a price exceeding the value of such lands: the other ground is that the Defendants have raised money in a manner not authorized by their powers under their Act of Incorporation; and especially that they have mortgaged or incumbered the lands and property of the company, and applied the monies thereby raised in effect, though circuitously, to pay the price of the land which they had so bought of themselves.

I do not now express any opinion upon the question whether, leaving out of view the special form in which the Plaintiffs have proceeded in the suit, the bill alleges a case in which a Court of Equity would say that the transactions in question are to be opened or dealt with in the manner which this bill seeks that they should be; but 1 certainly would not be understood by anything I said during the argument to do otherwise than express my cordial concurrence in the doctrine laid down in the case of *Hichens* v. *Congreve* (4 Russ. 562) and other cases of that class. I take those cases to be in accordance with the principles of this Court, and to be founded on **[489]** justice and commonsense. Whether particular cases fall within the principle of *Hichens* v. *Congreve* is another question. In *Hichens* v. *Congreve* property was sold to a company by persons in a fiduciary character, the conveyance reciting that £25,000 had been paid for the purchase; the fact being that £10,000 only had been paid, £15,000 going into the hands of the persons to whom the purchase was entrusted. I should not be in the least degree disposed to limit the operation of that doctrine in any case in which a person projecting the formation of a company invited the public to join him in the project, on a representation that he had acquired property which was intended to be applied for the purposes of the company. I should strongly incline to hold that to be an invitation to the public to participate in the benefit of the property purchased, on the

terms on which the projector had acquired it. The fiduciary ***203** character of the projector would, in such a case, commence from the time when he first began to deal with the public, and would of course be controlled in equity by the representation he then made to the public. If persons, on the other hand, intending to form a company, should purchase land with a view to the formation of it, and state at once that they were the owners of such land, and proposed to sell it at a price fixed, for the purposes of the company about to be formed, the transaction, so far as the public are concerned, commencing with that statement, might not fall within the principle of *Hichens* v. *Congreve.* A party may have a clear right to say: "I begin the transaction at this time; I have purchased land, no matter how or from whom, or at what price; I am willing to sell it a certain price for a given purpose." It is not necessary that I should determine the effect of the transactions that are stated to have occurred in the present case. I make these observations only that I may not be supposed, from anything which fell from me during the argu- **[490]** -ment, to entertain the slightest hesitation with regard to the application, in a proper case, of the principles I have referred to. For the present purpose I shall assume that a case is stated entitling the company, as matters now stand, to complain of the transactions mentioned in the bill.

The Victoria Park Company is an incorporated body, and the conduct with which the Defendants are charged in this suit is an injury not to the Plaintiffs exclusively; it is an injury to the whole corporation by individuals whom the corporation entrusted with powers to be exercised only for the good of the corporation. And from the case of *The Attorney-General* v. *Wilson* (Cr. & Ph. 1) (without going further) it may be stated as undoubted law that a bill or information by a corporation will lie to be relieved in respect of injuries which the corporation has suffered at the hands of persons standing in the situation of the directors upon this record. This bill, however, differs from that in *The Attorney-General* v. *Wilson* in this—that, instead of the corporation being formally represented as Plaintiffs, the bill in this case is brought by two individual corporators, professedly on behalf of themselves and all the other members of the corporation, except those who committed the injuries complained of—the Plaintiffs assuming to themselves the right and power in that manner to sue on behalf of and represent the corporation itself.

It was not, nor could it successfully be, argued that it was a matter of course for any individual members of a corporation thus to assume to themselves the right of suing in the name of the corporation. In law the corporation and the aggregate members of the corporation are not the same thing for purposes like this; and the **[491]** only question can be whether the facts alleged in this case justify a departure from the rule which, *primâ facie* , would require that the corporation should sue in its own name and in its

corporate character, or in the name of someone whom the law has appointed to be its representative.

The demurrers are—first, of three of the directors of the company, who are also alleged to have sold lands to the corporation under the circumstances charged; secondly, of Bealey, also a director, alleged to have made himself amenable to the jurisdiction of the Court to remedy the alleged injuries, though he was not a seller of land; thirdly, of Denison, a seller of land, in like manner alleged to be implicated in the frauds charged, though he was not a director; fourthly, of Mr. Bunting, the solicitor, and Mr. Lane, the architect of the company. These gentlemen are neither directors nor sellers of lands, but all the frauds are alleged to have been committed with their privity, and they also are in this manner sought to be implicated in them. The most convenient course will be to consider the demurrer of the three against whom the strongest case is stated; and the consideration of that case will apply to the whole.

The first objection taken in the argument for the Defendants was that the individual members of the corporation cannot in any case sue in the form in which this bill is framed. During the argument I intimated an opinion, to which, upon further consideration, I fully adhere, that the rule was much too broadly stated on the part of the Defendants. I think there are cases in which a suit might properly be so framed. Corporations like this, of a private nature, are in truth little more than private partnerships; and in cases which may easily be suggested it would be too much to hold that a society **[492]** of private persons associated together in under- ***204** takings, which, though certainly beneficial to the public, are nevertheless matters of private property, are to be deprived of their civil rights, *inter se* , because, in order to make their common objects more attainable, the Crown or the Legislature may have conferred upon them the benefit of a corporate character. If a case should arise of injury to a corporation by some of its members, for which no adequate remedy remained, except that of a suit by individual corporators in their private characters, and asking in such character the protection of those rights to which in their corporate character they were entitled, I cannot but think that the principle so forcibly laid down by Lord Cottenham in *Wallworth* v. *Holt* (4 Myl. & Cr. 635; see also 17 Ves. 320, *per* Lord Eldon) and other cases would apply, and the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporations are required to sue.

But, on the other hand, it must not be without reasons of a very urgent character that established rules of law and practice are to be departed from, rules which, though in a sense technical, are founded on general principles of justice and convenience; and the question is whether a case is stated in this bill entitling the Plaintiffs to sue in their

private characters. [His Honor stated the substance of the Act, sections 1, 38, 39, 43, 46, 47, 48, 49, 67, 70, 114 and 129 (*supra* , p. 464, n. *et seq.*).] The result of these clauses is that the directors are made the governing body, subject to the superior control of the proprietors assembled in general meetings; and, as I understand the Act, the proprietors so assembled have power, due notice being given of the purposes of the meeting, to originate proceedings for any purpose within **[493]** the scope of the company's powers, as well as to control the directors in any Acts which they may have originated. There may possibly be some exceptions to this proposition, but such is the general effect of the provisions of the statute.

Now, that my opinion upon this case may be clearly understood, I will consider separately the two principal grounds of complaint to which I have adverted, with reference to a very marked distinction between them. The first ground of complaint is one which, though it might *primâ facie* entitle the corporation to rescind the transactions complained of, does not absolutely and of necessity fall under the description of a void transaction. The corporation might elect to adopt those transactions, and hold the directors bound by them. In other words, the transactions admit of confirmation at the option of the corporation. The second ground of complaint may stand in a different position; I allude to the mortgaging in a manner not authorized by the powers of the Act. This, being beyond the powers of the corporation, may admit of no confirmation whilst any one dissenting voice is raised against it. This distinction is found in the case of *Preston* v. *The Grand Collier Dock Company* (11 Sim. 327, S. C.; 2 Railway Cases, 335).

On the first point it is only necessary to refer to the clauses of the Act to shew that, whilst the supreme governing body, the proprietors at a special general meeting assembled, retain the power of exercising the functions conferred upon them by the Act of Incorporation, it cannot be competent to individual corporators to sue in the manner proposed by the Plaintiffs on the present record. This in effect purports to be a suit by *cestui que trusts* complaining of a fraud committed or **[494]** alleged to have been committed by persons in a fiduciary character. The complaint is that those trustees have sold lands to themselves, ostensibly for the benefit of the *cestui que trusts.* The proposition I have advanced is that, although the Act should prove to be voidable, the *cestui que trusts* may elect to confirm it. Now, who are the *cestui que trusts* in this case? The corporation, in a sense, is undoubtedly the *cestui que trust;* but the majority of the proprietors at a special general meeting assembled, independently of any general rules of law upon the subject, by the very terms of the incorporation in the present case, has power to bind the whole body, and every individual corporator must be taken to have come into the corporation upon the terms of being liable to be so bound. How then can this Court act in a suit constituted as this is, if it is to be

assumed, for the purposes of the argument, that the powers of the body of the proprietors are still in existence, and may lawfully be exercised for a purpose like that I have suggested? Whilst the Court may be declaring the acts complained of to be void at the suit of the present Plaintiffs, who in fact may be the only proprietors who disapprove of them, the governing body of proprietors may ***205** defeat the decree by lawfully resolving upon the confirmation of the very acts which are the subject of the suit. The very fact that the governing body of proprietors assembled at the special general meeting may so bind even a reluctant minority is decisive to shew that the frame of this suit cannot be sustained whilst that body retains its functions. In order then that this suit may be sustained it must be shewn either that there is no such power as I have supposed remaining in the proprietors, or, at least, that all means have been resorted to and found ineffectual to set that body in motion: this latter point is nowhere suggested in the bill: there is no suggestion that an attempt has been made by any proprietor to set the body of proprietors in **[495]** motion, or to procure a meeting to be convened for the purpose of revoking the acts complained of. The question then is whether this bill is so framed as of necessity to exclude the supposition that the supreme body of proprietors is now in a condition to confirm the transactions in question; or, if those transactions are to be impeached in a Court of Justice, whether the proprietors have not power to set the corporation in motion for the purpose of vindicating its own rights.

[His Honor recapitulated the history and present situation of the company, as it appeared upon the bill.]

I pause here to examine the difficulty which is supposed by the bill to oppose itself to the body of proprietors assembling and acting at an extraordinary general meeting. The 48th section of the Act says that a certain number of proprietors may call such a meeting by means of a notice to be addressed to the board of directors, and left with the clerk or secretary, at the principal office of the company, one month before the time of meeting, or the board is not bound to notice it. The bill says that there is no board of directors properly constituted, no clerk, no principal office of the company, no power of electing more directors, and that, the appointment of the clerk being in the board of directors, no clerk can in fact now be appointed. I am certainly not prepared to go the whole length of the Plaintiff's argument founded upon the 48th section. I admit that the month required would probably be considered imperative; but is not the mode of service directory only? Could the board of directors *de facto* , for the time being, by neglecting to appoint a clerk or have a principal office, deprive the superior body, the body of proprietors, of the power which the Act gives that body over the board of directors? Would not a notice in substance, a notice for example such as the 129th sec- **[496]** -tion provides for in other cases, be a sufficient notice? Is not the

particular form of notice which is pointed out by the 48th section a form of notice given only for the convenience of the proprietors and directors? And if an impediment should exist, and, *à fortiori* , if that impediment should exist by the misconduct of the board of directors, it would be difficult to contend with success that the powers of the corporation are to be paralyzed, because there is no clerk on whom service can be made. I require more cogent arguments than I have yet heard to satisfy me that the mode of service prescribed by the 48th section, if that were the only point in the case, is more than directory. The like observations will apply to the place of service; but, as to that, I think the case is relieved from difficulty by the fact that the business of the company is stated to be principally conducted at the office of the solicitors, for I am not aware that there is anything in the statute which attaches any peculiar character to the spot designated as the principal office. In substance, the board of directors *de facto* , whether qualified or not, carry on the business of the company at a given place, and under this Act of Parliament it is manifest that service at that place would be deemed good service on the company.

If that difficulty were removed, and the Plaintiff should say that by the death or bankruptcy of directors, and the carelessness of proprietors (for that term must be added), the governing body has lost its power to act, I should repeat the inquiries I have before suggested, and ask whether, in such a case also, the 48th section is not directory, so far as it appears to require the refusal or neglect of the board of directors to call a general meeting, before the proprietors can by advertisement call such a meeting for themselves. Adverting to the undoubted powers conferred upon the proprietors to hold special general meetings without the consent and **[497]** against the will of the board of directors, and the permanent powers which the body of proprietors must of necessity have, I am yet to be persuaded that the existence of this corporation (for without a lawful governing body it cannot usefully or practically ***206*** continue) can be dependent upon the accidents which at any given moment may reduce the number of directors below three. The board of directors, as I have already observed, have no power to put a *veto* upon the will of any ten proprietors who may desire to call a special general meeting; and if ten proprietors cannot be found who are willing to call a special general meeting, the Plaintiffs can scarcely contend that this suit can be sustained. At all events what is there to prevent the corporators from suing in the name of the corporation? It cannot be contended that the body of proprietors have not sufficient interest in these questions to institute a suit in the name of the corporation. The latter observations, I am aware, are little more than another mode of putting the former questions which I have suggested. I am strongly inclined to think, if it were necessary to decide these points, it could not be successfully contended that the clauses of the Act of Parliament which are referred to are anything more than directory, if it be, indeed, impossible from accident to pursue the form directed by the

Act. I attribute to the proprietors no power which the Act does not give them: they have the power, without the consent and against the will of the directors, of calling a meeting, and of controlling their acts; and if by any inevitable accident the prescribed form of calling a meeting should become impracticable, there is still a mode of calling it, which, upon the general principles that govern the powers of corporations, I think would be held to be sufficient for the purpose.

It is not, however, upon such considerations that I **[498]** shall decide this case. The view of the case which has appeared to me conclusive is that the existence of a board of directors *de facto* is sufficiently apparent upon the statements in the bill. The bankruptcy of Westhead, the last of the three directors who became bankrupt, took place on the 2d of January 1840: the bill alleges that he thereupon ceased to be *qualified* to act as director, and his office became vacated; but it does not say that he ceased to *act* as a director; nor, although it is said that thenceforward there was no board "properly constituted," is it alleged that there was no board *de facto* exercising the functions of directors. These, and several other statements of the bill, are pregnant with the admission of the existence of a board *de facto.* By whom was the company governed, and its affairs conducted, between the time of Westhead's bankruptcy and that of the filing of the bill in October 1842? What directors or managers of the business of the company have lent their sanction to the mortgages and other transactions complained of, as having taken place since January 1840, and by which the corporation is said or supposed to be, at least to some extent, legally bound? Whatever the bill may say of the *illegal* constitution of the board of directors, because the individual directors are not duly qualified, it does not anywhere suggest that there has not been during the whole period, and that there was not when the bill was filed, a board of directors *de facto* , acting in and carrying on the affairs of the corporation, and whose acting must have been acquiesced in by the body of proprietors; at least, ever since the illegal constitution of the board of directors became known, and the acts in question were discovered. But if there has been or is a board *de facto* , their acts may be valid, although the persons so acting may not have been duly qualified. The 114th section (not stated in the bill) of the Act provides **[499]** that all acts, deeds and things done or executed at any meeting of the directors, by any person acting as a director of the said company, shall, notwithstanding it may afterwards be discovered that there was some defect or error in the appointment of such director, or that such director was disqualified, or being an *interim* director, was disapproved of by an annual general meeting of proprietors, be as valid and effectual as if such person had been duly appointed and was qualified to be a director. The foundation upon which I consider the Plaintiffs can alone have a right to sue in the form of this bill must wholly fail, if there has been a governing body of directors *de facto.* There is no longer the impediment to convening a meeting of proprietors, who by their vote might direct

proceedings like the present to be taken in the name of the corporation or of a treasurer of the corporation (if that were necessary); or who, by rejecting such a proposal, would, in effect, decide that the corporation was not aggrieved by the transactions in questions. Now, since the 2d of January 1840, there must have been three annual general meetings of the company held in July in every year, according to the provisions of the Act. These ***207** annual general meetings can only be regulary called by the board of directors. The bill does not suggest that the requisitions of the Act have not been complied with in this respect, either by omitting to call the meeting, or by calling it informally; but the bill, on the contrary, avers that several general meetings and extraordinary general meetings, and other meetings of the shareholders of the company, were duly convened and held at divers times between the time when the company was established and the year 1841; including, therefore, in this period of formality of proceeding, as well as of capacity in constitution, an entire year after Westhead's bankruptcy.

[500] Another statement of the bill leading to the same inference—the existence of an acting board—is that which avers that since the year 1839 down, in fact, to the time of filing the bill, that is, during these three years, the company has had no office of its own, but the affairs of the company have been principally conducted at the office of Mr. Bunting. Now this, as I must read it, is a direct admission that the affairs of the company have been carried on by some persons. By whom then have they been carried on? The statute makes the board of directors the body by whom alone those affairs are to be ordered and conducted. There is no other person or set of persons empowered by the Act to conduct the affairs of the company; and there is no allegation in the bill that any persons, other than the board of directors originally appointed, have taken upon themselves that business. In the absence of any special allegation to the contrary I am bound to assume that the affairs of the company have been carried on by the body in whom alone the powers for that purpose were vested by the Act, namely, a board of directors.

Again the bill alleges that, since the bankruptcy of Westhead, the bankrupts have joined in executing the conveyances of the property of the company to mortgagees. It could only have been in the character of directors that they could confer any title by the conveyance; in that character the mortgagees would have required them to be parties, and it is in that character that I must assume they executed the deeds.

If the case rested here, I must of necessity assume the existence of a board of directors, and in the absence of any allegation that the board *de facto* , in whose acting the company must, upon this bill, be taken to have acquiesced, have been applied to and have refused to ap- **[501]** -point a clerk and treasurer (if that be necessary), or

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take such other steps as may be necessary for calling a special general meeting, or had refused to call such special general meeting, the bill does not exclude every case which the pleader was bound to exclude in order to justify a suit on behalf of a corporation, in a form which assumes its practical dissolution. But the bill goes on to shew that special general meetings have been holden since January 1840. The bill, as I have before observed, states that several general meetings and extraordinary general meetings have been holden between the establishment of the company and the year 1841, not excluding the year 1840, which was during Westhead's disqualification, "and that at such meetings false and delusive statements respecting the circumstances and prospects of the company were made by the said directors of the company to the proprietors who attended such meetings, and the truth of the several fraudulent and improper acts and proceedings herein complained of was not disclosed;" and the bill specifies some meetings in particular. Against the pleader I must intend that some such meetings may have been holden at a time when there was no board properly constituted, and no clerk or treasurer or principal office of the company, save such as appear by the bill to have existed; and if that were so, the whole of the case of the Plaintiffs, founded on the impracticability of calling a special general meeting, fails. Assuming then, as I am bound to do, the existence, for some time at least, of a state of things in which the company was governed by a board of directors *de facto* , some of the members of which were individually disqualified, and in which, notwithstanding the want of a clerk, treasurer or office, the powers of the proprietors were called into exercise at general meetings, the question is, when did that state of things cease to exist, so as to justify the extraordinary proceeding of the Plain- **[502]** -tiffs by this suit? The Plaintiffs have not stated by their bill any facts to shew that such was not the actual state of things at the time their bill was filed, and, in the absence of any statement to the contrary, I must intend that it was so. ***208***

The case of *Preston* v. *The Grand Collier Dock Company* was referred to as an example of a suit in the present form; but there the circumstances were in no respect parallel with the present: the object of that suit was to decide the rights or liabilities of one class of the members of the corporation against another, in respect of a matter in which the corporation itself had no power to vary the situation of either.

I have applied strictly the rule of making every intendment against the pleader in this case—that is, of intending everything to have been lawful and consistent with the constitution of the company, which is not expressly shewn on the bill to have been unlawful or inconsistent with that constitution. And I am bound to make this intendment, not only on the general rule, but also on the rules of pleading which require a Plaintiff to frame his case so distinctly and unambiguously, that the Defendant may not be embarrassed in determining on the form which his defence

should assume. *Attorney-General* v. *Corporation of Norwich* (2 Myl. & Cr. 406). The bill, I cannot but observe, is framed with great care, and with more than ordinary professional skill and knowledge; but the averments do not exclude that which, *primâ facie* , must be taken to have been the case, that during the years 1840, 1841 and 1842 there was a governing body, that by such body the business of the company was carried on, that there was no insurmountable impediment to the **[503]** exercise of the powers of the proprietors assembled in general meetings to control the affairs of the company, and that such general meetings were actually held. The continued existence of a board *de facto* is not merely not excluded by the averments, but the statements in the bill of the acts which have been done suppose, and even require, the existence of such a board. Now, if the Plaintiff had alleged that there had been no board of directors *de facto* , and had on that ground impeached the transactions complained of, the Defendants might have met the case by plea, and thereby have defended themselves from answering the bill. If it should be said that the Defendants might now have pleaded that there was a board of directors *de facto* , the answer is that they might then have been told that the fact sufficiently appeared upon the bill, and therefore they ought to have demurred. Uncertainty is a defect in pleading of which advantage may be taken by demurrer. If I were to overrule these demurrers, I might be depriving the Defendants of the power of so protecting themselves; and that because the Plaintiff has not chosen, with due precision, to put forward that fact, which, if alleged, might have been met by plea, but which, not being so alleged, leaves the bill open to demurrer.

I must further observe that, although the bill does, with great caution, attempt to meet every case which, it was supposed, might have been fatal to it upon demurrer, yet it is by allegations of the most general kind, and many of which cannot by possibility be true. It alleges the recent discovery of the acts complained of, but it gives no allegation whatsoever for the purpose of telling when or how such discovery was made, or what led to it. I am bound to give the Plaintiff, on a general demurrer, the benefit of the allegation that the matters complained of have been recently discovered, whatever the term "re- **[504]** -cently discovered" may mean; but when I look into the schedule to the Act I find that many of those matters must have been known at a very early period in the history of the company. I find also provisions of the Act requiring that books shall be kept in which all transactions shall be fully and fairly stated; and I do not find in the bill anything like a precise allegation that the production of those books would not have given the information, or that there have not been means of seeing those books at least at some time since 1835, or since the transactions in question took place, so that, in point of fact, many of the transactions might and may have been sooner known. These are observations upon which I do not found my judgment, but

which I use as explaining why it is I have felt bound in favour of the Defendants to construe this bill with strictness.

The second point which relates to the charges and incumbrances alleged to have been illegally made on the property of the company is open to the reasoning which I have applied to the first point, upon the question whether, in the present case, individual members are at liberty to complain in the form adopted by this bill; for why should this anomalous form of suit be resorted to, if the powers of the corporation may be called into exercise? But this part of the case is of greater difficulty upon the merits. I follow, with entire assent, the opinion expressed by the Vice- ***209** Chancellor in *Preston* v. *The Grand Collier Dock Company* , that if a transaction be void, and not merely voidable, the corporation cannot confirm it, so as to bind a dissenting minority of its members. But that will not dispose of this question. The case made with regard to these mortgages or incumbrances is, that they were executed in violation of the provisions of the Act. The mortgagees are not Defendants to the bill, nor does the bill seek to avoid the **[505]** security itself, if it could be avoided, on which I give no opinion. The bill prays inquiries with a view to proceedings being taken *aliunde* to set aside these transactions against the mortgagees. The object of this bill against the Defendants is to make them individually and personally responsible to the extent of the injury alleged to have been received by the corporation from the making of the mortgages. Whatever the case might be, if the object of the suit was to rescind these transactions, and the allegations in the bill shewed that justice could not be done to the shareholders without allowing two to sue on behalf of themselves and others, very different considerations arise in a case like the present, in which the consequences only of the alleged illegal Acts are sought to be visited personally upon the directors. The money forming the consideration for the mortgages was received, and was expended in, or partly in, the transactions which are the subject of the first ground of complaint. Upon this, one question appears to me to be, whether the company could confirm the former transactions, take the benefit of the money that has been raised, and yet, as against the directors personally, complain of the acts which they have done, by means whereof the company obtains that benefit which I suppose to have been admitted and adopted by such confirmation. I think it would not be open to the company to do this; and my opinion already expressed on the first point is that the transactions which constitute the first ground of complaint may possibly be beneficial to the company, and may be so regarded by the proprietors, and admit of confirmation. I am of opinion that this question—the question of confirmation or avoidance—cannot properly be litigated upon this record, regard being had to the existing state and powers of the corporation, and that therefore that part of the bill which seeks to visit the directors personally with the consequences of the impeached mortgages and charges, the benefit of which **[506]** the company enjoys, is in the same predicament as that which relates to the

other subjects of complaint. Both questions stand on the same ground, and, for the reasons which I stated in considering the former point, these demurrers must be allowed.

Hare

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1. The substance of the Act, as stated in the bill, was as follows:—Section 3. The company empowered to purchase the lands mentioned in the schedule; 5. And other lands within a mile from the boundary of the said lands; 15. For a sum or sums in gross, or annual rent service or perpetual rent-charge (notwithstanding the existence of any unperformed contract for the sale of any such lands to the company of proprietors, or any of them). 16. Power to lay out the lands; and build thereon, as the directors might think proper. 18. Capital to be £500,000, and to be applied first, in payment of the expenses of obtaining the Act; and then in payment of the purchase-monies of the lands, and making and maintaining the parks and buildings, and the other purposes of the Act. 19. None of the powers given by the Act to be exercised before £50,000 should be raised. 20. The capital to be divided in 5000 shares of £100 each. 22. The shares to be personal estate. 23, 24, 25, 26, 27. Provisions with respect to the nominees of shareholders, and the duration of the interests of the shareholders, on the principle of tontine. 29. Register of the names and additions of shareholders and their nominees to be kept by the clerk or secretary of the company, and the common seal affixed thereto. 34. Directors to make calls, and enforce payment of the same, such calls not to exceed £10 per share at one time, and to be at least two months from each other: the money to be put into the hands of the treasurer, and applied as aforesaid. 35. Declaration and evidence necessary in actions for calls. 38. That the business affairs and concerns of the company shall, from time to time, and at all times hereafter, be under the control of five shareholders (to be appointed directors), who shall have the entire ordering, managing and conducting of the company, and of the capital, estates, revenue, effects and affairs, and other the concerns thereof, and who shall also regulate and determine the mode and terms of carrying on and conducting the business and affairs of the company, conformably to the provisions contained in this Act; and no proprietor, not being a director, shall, on any account or pretence whatsoever, in any way meddle or interfere in the managing, ordering or conducting the company, or the capital, estates, revenue, effects or other the business, affairs or concerns thereof, but shall fully and entirely commit, entrust and leave the same to be wholly ordered, managed and conducted by the directors for the time being, and the persons whom they shall appoint, save as hereinafter mentioned. 39. That the said T. Harbottle, J. Adshead, H. Byrom, J. Westhead and R. Bealy shall be the present and first directors of the company. 40. Three directors to constitute a board, and the acts of three or more to be as effectual as if done by the five. 42. Minutes of the proceedings of every board to be entered in a book to be kept by the clerk or secretary at the office of the company. 43. The board of directors for the time being to have full power and authority to appoint or remove the banker, broker, architect, surveyor, solicitor, builder, treasurer and clerk, and also a secretary, and all other agents, officers, clerks and servants. 45. Books of account of all the transactions of the company to be kept, and half-yearly reports and balance-sheets to be made: the proprietors to have access to, and to be at liberty to inspect, all books, accounts, documents and writings belonging to the company, at all reasonable times. 46. That a meeting of the proprietors of the company shall be convened and held on the first Monday in the month of July 1837, and on the same day in every succeeding year, at eleven o'clock in the forenoon, at their office, or such other convenient place in Manchester as the directors may think proper to appoint, of which meeting the clerk or secretary for the time being of the company shall give fourteen days' previous notice, by an advertisement in one of the Manchester newspapers; and each meeting so to be convened and held shall be called "The Annual General Meeting," and the proprietors respectively qualified to act and vote therein, according to the provisions therein contained, and who personally, or by such proxy as hereinafter authorised, shall attend the same shall have full power and authority to decide upon all such matters and questions as by virtue of this Act shall be brought before such annual general meeting. 47. Board of directors empowered to call extraordinary general meetings. 48. That ten or more proprietors of the company for the time being qualified to vote as hereinafter mentioned, or three full

fourth parts in number and value of all the proprietors for the time being of the company may, at any time, by writing under their hands, require the board of directors for the time being to call an extraordinary general meeting of the proprietors, and every such requisition shall set forth the object of such extraordinary meeting, and shall be left with the clerk or secretary for the time being at the principal office of the company, at least one calendar month before the time named in the requisition for the meeting to be holden, otherwise the said board shall not be bound to take notice thereof; but in case the directors shall refuse or neglect for fourteen days, after such requisition shall be so left as aforesaid, to call such extraordinary meeting, then the proprietors signing the requisition may, for the purposes mentioned in such requisition, call an extraordinary general meeting of the proprietors, by notice signed by them, and advertised in one or more of the Manchester newspapers, at least fourteen days before the time fixed for holding the meeting; and in every such advertisement the object of such extraordinary meeting, and the day and hour and place in the town of Manchester of holding the same, and the delivery of the requisition to the said board, and of its refusal to call such extraordinary meeting, shall be specified. 65. Two of the directors selected by lot amongst themselves to retire from office at the annual general meeting in July 1841, and be replaced by two qualified proprietors, to be then elected by the majority of votes at such meeting, and two others, the longest in office, or so selected to retire, at every subsequent annual general meeting; but the retiring directors to be re-eligible. 67. No person shall be a director who shall not be a holder in his own right of the number of shares hereinafter mentioned in the capital of the company, viz., who shall not be a holder of ten shares at least, so long as the total number of the shares shall exceed 500; and from and after the total number of shares of the company shall be reduced to and shall not exceed 100, then who shall not be a holder of five shares at least; and, if any of the then or future directors shall cease to hold the respective number of shares aforesaid in his own right, his office as director shall thereupon and thenceforth become vacated. 68. Directors may vacate by resigning their offices. 70. Board of directors to appoint qualified persons to fill up the offices of directors dying, resigning, removed or becoming disqualified before their time of retirement; such appointments to be subject to the approbation of the next general meeting. 73. Cheques, bills, notes and other negotiable securities to be signed, &c., by the treasurer or such other officer of the company as the board should by minute appoint, and no others to be binding on the company. 74. That all actions, suits and other proceedings at law or in equity to be commenced and prosecuted by or on behalf of the company shall and lawfully may be commenced and instituted or prosecuted in the name of the treasurer, or any one of the directors of the company for the time being, as the nominal Plaintiff for and on behalf of the company; and all actions, &c., against the company shall be commenced and instituted and prosecuted against the treasurer, or any one of the directors of the company for the time being, as the nominal Defendant for and on behalf of the company. 78. Directors to have power to sell or declare forfeited shares for non-payment of debts or liabilities to the company. 83, 84, 85. Shares vested in executors, legatees and assignees of proprietors, upon being transferred and duly registered, and such executors, legatees, assignees, &c., to be liable to calls, &c., as if original proprietors. 90. After one-half of the capital of £500,000 should have been paid up, the board of directors, with the sanction of a general meeting, empowered to borrow at interest any sum or sums of money, not exceeding £150,000 in the whole, on the security of the lands, property and effects of the company, by deed or writing under their common seal: entries of all such mortgages, and the particulars thereof, to be made in a book to be kept by the clerk of the company, and such book to be open for the perusal at all reasonable times of any proprietor or creditor of the company. 93. Mortgagees not required to see to the necessity for or application of the mortgage money. 105. Board of directors, with the sanction of two successive general meetings, and the proportion in number and value of the proprietors and shares therein mentioned, empowered to put an end to the tenure by way of tontine, and discharge the shares from all benefit of survivorship. 107, 108. Power to dissolve the company, and wind up the affairs thereof, in manner therein mentioned, under the sanction of such general meetings. 112. Notices to proprietors sent by post, according to their addresses in the register, to be sufficient. 129. That in all cases wherein it may be requisite or necessary for any person or party to serve any notice, or any writ or other legal proceedings upon the said company, the service thereof upon the clerk or secretary to the company, or any agent or officer employed by the said director, or leaving the same at the office of such clerk or secretary, agent or officer, or at his last or usual place of abode, or upon any one of the said directors, or delivery thereof to some

inmate at his last or usual place of abode, shall be deemed good and sufficient service of the same respectively on the company or their directors.

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EDWARDS AND ANOTHER *v.* HALLIWELL AND OTHERS.

[COURT OF APPEAL (Sir Raymond Evershed, M.R., Asquith and Jenkins, L.JJ.), October 31, November 1, 2, 1950.]

Trade Union—Action by member against union—Matter of substance, tinctured with oppression—Invasion of members' individual rights.

Rule 19 of the rules of the defendant trade union provided: "The regular contributions of employed members shall be as per tables . . . and no alteration to same shall be made until a ballot vote of the members has been taken and a two-thirds majority obtained." In December, 1943, a delegate meeting of the union, without taking any ballot, passed a resolution increasing the amount of the contributions of employed members. The plaintiffs, two members of the union, claimed against two members of the executive committee of the union and the union itself a declaration that the alteration adopted at the delegate meeting was invalid. A B

HELD: (i) as the matter in question was not a mere irregularity in the internal management of the union, but was a matter of substance and tinctured with oppression, the court would grant the plaintiffs relief if it was proper to do so.

Amalgamated Society of Engineers v. *Jones* (1913) (29 T.L.R. 484), *distinguished.* C

(ii) it was implicit in the rule in *Foss* v. *Harbottle* (1843) (2 Hare 461) that the matter relied on as constituting the cause of action should be a cause of action properly belonging to the general body of members of the association in question as opposed to a cause of action which some individual member could assert in his own right. In the present case, the personal and individual rights of membership of the plaintiffs had been invaded and particular damage inflicted by the invalid alteration of the tables of contributions, and in such circumstances the rule in *Foss* v. *Harbottle* had no application to individual members who were suing, not in the right of the union, but in their own right to protect from invasion their individual rights as members, and, therefore, the plaintiffs were entitled to their declaration. D E

Pender v. *Lushington* (1877) (6 Ch.D. 70), *applied.*

Per JENKINS, L.J.: The rule in *Foss* v. *Harbottle* does not prevent an individual member suing if the matter in respect of which he is suing can validly be done, not by a simple majority of the members of the association, but, as in the present case, only by some special majority: *Cotter* v. *National Union of Seamen* ([1929] 2 Ch. 58), *applied* . . . I cannot regard the paying by the majority of the members of the increased rates without demur as equivalent to a ballot vote at which a two-thirds majority was obtained in favour of the alteration. F

[AS TO THE AMENDMENT OF THE RULES OF A TRADE UNION, see HALSBURY, Hailsham Edn., Vol. 32, p. 494, para. 787; and FOR CASES, see DIGEST, Vol. 43, p. 101, Nos. *1048-1052*, and Digest Supp.] G

Cases referred to:

(1) *Foss* v. *Harbottle,* (1843), 2 Hare 461; 67 E.R. 189; 13 Digest 417, *1377*.

(2) *Amalgamated Society of Engineers* v. *Jones,* (1913), 29 T.L.R. 484; 43 Digest 101, *1050*.

(3) *Cotter* v. *National Union of Seamen,* [1929] 2 Ch. 58; 98 L.J.Ch. 323; 141 L.T. 178; Digest Supp. H

(4) *Pender* v. *Lushington,* (1877), 6 Ch.D. 70; 46 L.J.Ch. 317; 9 Digest 572, *3800*.

APPEAL by the defendants from a judgment of VAISEY, J., dated July 28, 1950.

The plaintiffs, two members of the Cricklewood branch of the defendant union, claimed a declaration on behalf of themselves and all other members of the branch that the alteration of the general rules of the union adopted at

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a delegate meeting in December, 1943, was invalid in so far as it purported to alter the amount of the regular contributions of employed members. The defendants were two members of the executive committee of the union sued as representatives of the committee and the union. VAISEY, J., granted the declaration. The facts appear in the judgment of ASQUITH, L.J.

Pascoe Hayward, K.C., and *Lindner* for the defendants.

A *Milner Holland, K.C.*, and *Hesketh* for the plaintiffs.

SIR RAYMOND EVERSHED, M.R.: I will ask ASQUITH, L.J., to deliver the first judgment.

ASQUITH, L.J.: This is an appeal by the defendants from a judgment of VAISEY, J., whereby he made a declaration asked for by the plaintiffs in B terms to which I will refer. The plaintiffs sue on behalf of themselves and all other members of the Cricklewood branch of the National Union of Vehicle Builders, a registered trade union. The defendants are sued on behalf of themselves and all other members of the executive committee of the union, and the union itself is joined as a defendant.

The main point in the appeal is whether VAISEY, J., has rightly construed C r. 19 of the rules of the union. The defendants contend that, even if he did rightly construe that provision, the plaintiffs are precluded, for other reasons, from obtaining the relief which they have been awarded. The only relevant part of r. 19 is the first five lines, which are:

> " The regular contributions of employed members shall be as per tables (pp. 115 and 116) and no alteration to same shall be made until a ballot D vote of the members has been taken and a two-thirds majority obtained."

In December, 1943, a delegate meeting was held at which the delegates, without any ballot, let alone a ballot resulting in a two-thirds majority, purported to increase the regular contributions of employed members and also certain benefits payable to the members. The plaintiffs contend that that alteration in the contributions is a nullity because the condition precedent to its validity laid E down in r. 19 had not been satisfied. They refused to pay the amount of the increase, and were threatened or actually visited with loss of their rights as union members, including that of eligibility for election to certain offices. In the action they claimed:

> " A declaration that the alteration of the general rules of the National F Union of Vehicle Builders adopted at a delegate meeting in December, 1943, is invalid in so far as it purports to alter the regular contributions of employed members."

[HIS LORDSHIP considered the rules of the union; held that, on construction of them, the alteration in December, 1943, of the rates of contribution was invalid, and continued:] The other point relied on by the defendants was that, even if they G were wrong on the point of construction, the court either could not, or should not, grant the plaintiffs the relief which they claim. Under this head counsel for the defendants relied on the alleged principle that, when an action is brought by an individual in respect of a mere irregularity in a matter that is *intra vires* a trade union and concerns its internal management, the court will not as a rule intervene. For this purpose he conceded that a " mere irregularity " meant H something not involving fraud, oppression or unfairness. I confess I should have thought the action complained of here was strongly tinctured, not, indeed, with fraud, but with " oppression " and " unfairness." Here were men who had a right not to have their contributions increased except after a ballot resulting in a two-thirds majority. This right was clearly violated. An unauthorised increase was sought to be extorted, and when they refused to pay, as they were entitled to do, severe penalties were imposed or threatened. To call this a mere informality or irregularity without any element of oppres-

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sion or unfairness would be an abuse of language. When in circumstances such as I have described a remedy is sought by an individual, complaining of a particular act in breach of his rights and inflicting particular damage on him, it seems to me the principle of *Foss* v. *Harbottle* (1), which has been so strongly relied upon by the defendants, does not apply either by way of barring the remedy or supporting the objection that the action is wrongly constituted because the union is not a plaintiff. Nor, lastly, can I accept the submission that, if the action is maintainable at law, it should nevertheless be dismissed because the vast majority of members approved the action taken by the defendants. The answer to the defendants' argument under this head will, I hope, be presented more fully by my Lords who are much more familiar with this branch of the law than myself. I think the appeal should be dismissed.

JENKINS, L.J., stated the facts and continued: I will pass to the argument based on the reluctance of the court to interfere with the domestic affairs of a company or association on the ground of mere irregularity in form in the conduct of those affairs, and the argument based on the more general proposition commonly called the rule in *Foss* v. *Harbottle* (1). As to the contention that, even though the purported alteration of the tables of contributions was invalid, the court should not interfere because the omission to hold a ballot and obtain a two-thirds majority as required by r. 19 was a mere irregularity in point of form, in my judgment, that argument can be shortly dismissed by saying that this was not a matter of form. It was a matter of substance. The relevant part of r. 19, I conceive, was designed to protect members against increases in the rates of contributions unless those increases were agreed to by a particular majority of members on a vote obtained in a particular way—that is to say, a two-thirds majority on a ballot vote. It seems to me that the executive committee's disregard of that express provision in the rules was a wrong done to each individual member on a point of substance. I say " on a point of substance," because it is *nihil ad rem* to point out that the increases in question were merely a matter of pence per week. In my judgment, this question should be viewed in precisely the same way as if the increase had been a matter of pounds, which might have made a substantial difference to the financial position of the members. In my judgment, the case cited on this part of the argument—*Amalgamated Society of Engineers* v. *Jones* (2)—has no bearing on the facts of the present case. In that case a meeting had been held and certain resolutions passed, and it was suggested that the mode of convening the meeting was irregular. The learned judge was able to hold that there had been no wrong done as a matter of substance, but that there had been a mere irregularity in procedure and he took the view that, in those circumstances, the court should not interfere. For the reasons I have endeavoured to state, I regard the present case as an entirely different one.

The rule in *Foss* v. *Harbottle* (1), as I understand it, comes to no more than this. First, the proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is *prima facie* the company or the association of persons itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company or association and on all its members by a simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company or association is in favour of what has been done, then *cadit quæstio*. No wrong had been done to the company or association and there is nothing in respect of which anyone can sue. If, on the other hand, a simple majority of members of the company or association is against what has been done, then there is no valid reason why the company or association itself should not sue. In my judgment, it is implicit in the rule that the matter relied on as constituting the cause of action should be a cause of action properly belonging to the general

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body of corporators or members of the company or association as opposed to a cause of action which some individual member can assert in his own right.

The cases falling within the general ambit of the rule are subject to certain exceptions. It has been noted in the course of argument that in cases where the act complained of is wholly *ultra vires* the company or association the rule has no application because there is no question of the transaction being confirmed by any majority. It has been further pointed out that where what A has been done amounts to what is generally called in these cases a fraud on the minority and the wrongdoers are themselves in control of the company, the rule is relaxed in favour of the aggrieved minority who are allowed to bring what is known as a minority shareholders' action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, B being in control, would not allow the company to sue. Those exceptions are not directly in point in this case, but they show, especially the last one, that the rule is not an inflexible rule and it will be relaxed where necessary in the interests of justice.

There is a further exception which seems to me to touch this case directly. That is the exception noted by ROMER, J., in *Cotter* v. *National Union of Sea-* C *men* (3). He pointed out that the rule did not prevent an individual member from suing if the matter in respect of which he was suing was one which could validly be done or sanctioned, not by a simple majority of the members of the company or association, but only by some special majority, as, for instance, in the case of a limited company under the Companies Act, a special resolution duly passed as such. As ROMER, J., pointed out, the reason for that exception D is clear, because otherwise, if the rule were applied in its full rigour, a company which, by its directors, had broken its own regulations by doing something without a special resolution which could only be done validly by a special resolution could assert that it alone was the proper plaintiff in any consequent action and the effect would be to allow a company acting in breach of its articles to do *de facto* by ordinary resolution that which according to its own regulations E could only be done by special resolution. That exception exactly fits the present case inasmuch as here the act complained of is something which could only have been validly done, not by a simple majority, but by a two-thirds majority obtained on a ballot vote. In my judgment, therefore, the reliance on the rule in *Foss* v. *Harbottle* (1) in the present case may be regarded as misconceived on that ground alone.

F I would go further. In my judgment, this is a case of a kind which is not even within the general ambit of the rule. It is not a case where what is complained of is a wrong done to the union, a matter in respect of which the cause of action would primarily and properly belong to the union. It is a case in which certain members of a trade union complain that the union, acting through the delegate meeting and the executive council in breach of the rules by which G the union and every member of the union are bound, has invaded the individual rights of the complainant members, who are entitled to maintain themselves in full membership with all the rights and privileges appertaining to that status so long as they pay contributions in accordance with the tables of contributions as they stood before the purported alterations of 1943, unless and until the scale of contributions is validly altered by the prescribed majority obtained H on a ballot vote. Those rights, these members claim, have been invaded. The gist of the case is that the personal and individual rights of membership of each of them have been invaded by a purported, but invalid, alteration of the tables of contributions. In those circumstances, it seems to me the rule in *Foss* v. *Harbottle* (1) has no application at all, for the individual members who are suing sue, not in the right of the union, but in their own right to protect from invasion their own individual rights as members.

I would be content so to hold as a matter of self-evident principle, but the

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matter is not free from authority. It will, I think, be enough for the present purposes if I refer, briefly, to a passage in the judgment of Sir George Jessel, M.R., in *Pender* v. *Lushington* (4). There was a discussion in the course of the case whether the action was one which an individual shareholder could maintain and Sir George Jessel, M.R., said (6 Ch.D. 80):

> "But there is another ground on which the action may be maintained. This is an action by Mr. Pender for himself. He is a member of the company, and whether he votes with the majority or the minority he is entitled to have his vote recorded—an individual right in respect of which he has a right to sue. That has nothing to do with the question like that raised in *Foss* v. *Harbottle* (1) and that line of cases. He has a right to say, 'Whether I vote in the majority or minority, you shall record my vote, as that is a right of property belonging to my interest in this company, and if you refuse to record my vote I will institute legal proceedings against you to compel you.' What is the answer to such an action? It seems to me it can be maintained as a matter of substance, and that there is no technical difficulty in maintaining it."

A

B

In my judgment, precisely the same conclusions as are there expressed apply in the present case, and the rule in *Foss* v. *Harbottle* (1) affords no answer to the action. It was sought to show that this was not a matter affecting the individual rights of any particular member of the union because all were subject to the same alteration of the tables and, therefore, it was a matter which affected the general body of members as a whole. I do not agree. For one thing, the contributions to be paid by any individual member would depend on the particular category of membership to which he belonged, but, for another thing and more important, it seems to me that, although all the members are liable to pay the subscriptions appropriate to their respective categories, the right of each member to maintain himself in membership by paying his subscription—that is to say, by paying whatever subscription appropriate to his case is validly fixed and for the time being in force under the rules—is an individual right of his own which he himself is entitled to protect by an action on his own behalf.

C

D

E

It was pointed out in the course of the argument (though the matter was not fully developed) that the vast majority of members of the union had, in fact, paid without demur subscriptions at the new and invalid rate. It was further pointed out that those who had become entitled to benefits had taken benefits at the enhanced rate. It was further pointed out that in practice r. 19 (1) had never been resorted to for many years. Before Vaisey, J., these matters seem to have been put forward as amounting to such acquiescence as to make r. 19 (1) a dead letter which could no longer be enforced. That argument was not pressed before us, but these considerations were put as showing that the case was without substance. It was said that the fact that the vast majority of members had paid the new rate of subscriptions without demur demonstrated that the will of the union as a whole was in favour of the new subscriptions and consequently the action was without substance. I cannot agree. I cannot regard the mere paying by individual members of the increased rates without demur as equivalent to a ballot vote at which a two-thirds majority was obtained in favour of the alteration. In my judgment, the scale of contributions as fixed in the rules before the disputed alteration must stand unless and until altered in accordance with r. 19. It not having been so altered, the rates so fixed remain the only rates properly exigible, and no member is bound to pay any other rate except as a matter of individual consent. It may well be that in most cases it would be found, when the particular member's account was gone into, that he had by his conduct in paying the new rate of subscription expressed his individual consent to the alteration and thereby become bound, but I see no ground in principle or in authority

F

G

H

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for holding that these individual assents arising from the conduct of individual members can have any binding effect at all on those members who say: "We are prepared to pay the contributions validly exigible under the rules and no more." Accordingly, I agree that the appeal fails and should be dismissed.

SIR RAYMOND EVERSHED, M.R.: I am entirely of the same opinion. On the question of the construction of the rules, the point was debated whether a delegate conference could validly by ordinary resolution of the conference revise r. 19 (1) by the abrogation or suspension of the words of prohibition on which the plaintiffs' action has been founded and then proceed by a further ordinary resolution to alter the rates of contribution payable, thereby avoiding any need to have a ballot or to obtain a two-thirds majority upon a ballot. I am not satisfied that, if a delegate conference made such an alteration or revision of r. 19 as a mere prelude to the alteration of the rates of contribution, such a procedure would successfully withstand challenge. If it is the desire of those responsible for the administration of the affairs of this union either to abrogate altogether the relevant prohibition in r. 19 or to make it inapplicable to an alteration of contribution rates by a delegate conference, I think prudence would demand that such a revision should receive the confirmation of the necessary two-thirds majority. Upon the *Foss* v. *Harbottle* (1) point, I should be guilty of repetition if I added anything to the reasons given by JENKINS, L.J., with which I find myself in entire agreement. The appeal fails and will be dismissed.

Appeal dismissed with costs.

Solicitors: *Rowley, Ashworth & Co.* (for the defendants); *Ernest Bevir & Son* (for the plaintiffs).

[*Reported by* F. GUTTMAN, ESQ., *Barrister-at-Law.*]

Re SCHAR (*deceased*). MIDLAND BANK EXECUTOR AND TRUSTEE CO., LTD. *v.* DAMER AND OTHERS.

[CHANCERY DIVISION (Vaisey, J.), November 7, 1950.]

Will—Joint tenancy—Disclaimer—Release—Purported disclaimer by one joint tenant.

By his will, dated Mar. 30, 1931, a testator, who died on Jan. 19, 1943, appointed a bank and two persons to be his executors and directed the payment of legacies and shares of his residuary estate to certain persons resident in Germany. By a codicil, dated May 31, 1940, he appointed F. and J. to be his executors with the bank in place of the persons appointed by the will, and declared that if, at the time of his death or at any time before his trustees had wound up his estate, legislation was in force in the United Kingdom by which some beneficiaries were deprived of the right to receive their benefits, then: "I give such benefits to my trustees absolutely with the request but without creating any trust that they will carry out the wishes contained in my said will or any codicil thereto when legislation permits them to do so." On Mar. 20, 1945, COHEN, J., held that, on the true construction of the will and codicil, the legacy and shares of residue thereby given to persons who survived the testator and were at his death enemies within the meaning of the Trading with the Enemy Act, 1939, were payable to the bank, F., and J. beneficially. On Nov. 19, 1945, the bank executed a deed in which the parties were described as the bank, of the one part, and F. and J. ("the beneficiaries"), of the other part. The deed, which was not executed by F. or J., recited the will and

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IESINI v WESTRIP HOLDINGS LTD

CHANCERY DIVISION (COMPANIES COURT)

Lewison J.: October 16, 2009

[2009] EWHC 2526 (Ch); [2010] B.C.C. 420

H1. *Derivative claims—Breach of directors' duties—Application for permission to continue derivative claim—Permission granted at first stage of application of prima facie case—Application at second stage—Requirements of second stage—Whether only prima facie case as at first stage—Position of director under s.172 duty—Good faith of applicant—Whether alternative remedy an absolute bar to permission—Views of independent member—Whether permission should be given—Companies Act 2006 ss.172, 260, 261, 263, 994, 996.*

H2. This was an application under s.261 of the Companies Act 2006 for permission to continue a derivative claim under s.260 of the Act against the newly constituted board of directors of a company for breach of duty.

H3. The company, "Westrip" was formed as a vehicle to raise and provide funding for the development of a mineral exploration licence in Greenland. An exclusive exploration licence for an area of West Greenland had been granted to an Australian company, "Rimbal", owned by "B" and "W", but this only covered exploration and not the extraction of metals. The terrain involved was such that extraction posed serious practical problems. Westrip agreed to purchase B and W's shares in Rimbal in return for the allotment of redeemable preference shares in Westrip to B and W, so that Westrip could exploit the licence. Westrip resolved to issue such shares without voting, dividend or winding-up rights. At that time, however, Westrip's articles of association did not allow for the issue of redeemable preference shares. Westrip and B and W later entered into an agreement which stated that Rimbal held its licence on trust for Westrip. If the agreement was breached by Westrip, B and W were entitled to rescind it and opt to retain the shares in Rimbal and sue for damages. Westrip adopted new articles of association enabling the directors to allot and issue compliant redeemable preference shares. Westrip entered a joint venture with another company to exploit the licence. "I", was a shareholder and director of Westrip and later he was suspended as director of the company. Westrip became financially unable to allot the redeemable preference shares and it was discovered that the shares had not been issued. The board was legally advised that B and W had a right to rescind. B and W gave notice exercising that right and sought to have the shares in Rimbal re-transferred to them. Westrip accepted the rescission and offered to settle Rimbal's claims to be substituted to the joint venture agreement.

H4. I and other Westrip shareholders applied under s.261 of the Companies Act 2006 for permission to continue a derivative claim and argued that Westrip's board had breached its duty by failing to consider defences which the company might advance to challenge the rescission, that it had a claim for restitution in respect of costs incurred in developing the licence, and that Westrip held the licence on trust so that Rimbal did not have the right to be substituted to the joint venture agreement. Norris

J. at the first stage of the application directed the application to proceed to the second stage (at which the company could provide evidence). At the second stage B, W and Rimbal submitted that s.263(2)(a) of the Companies Act 2006 required permission to be refused because a person acting in accordance with the s.172 duty to promote the success of the company would not seek to continue the claim. Westrip and some respondent board members argued that the claimants were not seeking to pursue the derivative action for Westrip's benefit, but for the collateral purpose of benefit of the joint venture company, which had provided them with an indemnity for costs and damages.

H5. Held, refusing permission to continue the derivative claim as it related to certain allegations but adjourning the application so far as it related to the trust claim:

H6. 1. Under the Companies Act 2006 s.260 a derivative claim was in respect of a cause of action vested in the company seeking relief on behalf of the company in respect of an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company. Section 261 provided for a two-stage procedure where a member wished to bring a derivative claim on behalf of the company. At the first stage, the applicant was required to make a prima facie case for permission to continue a derivative claim at which the court considered the question on the basis of the evidence filed by the applicant only, without requiring evidence from the defendant or the company. The court was required to dismiss the application if the applicant could not establish a prima facie case. The prima facie case to which s.261(1) referred was a prima facie case "for giving permission". This necessarily entailed a decision that there was a prima facie case both that the company had a good cause of action and that the cause of action arose out of a directors' default, breach of duty (etc.). Norris J. considered the first stage application on paper, and considered that there was a prima facie case. The second stage was now before the court.

H7. 2. At the second stage it was not simply a matter of establishing a prima facie case, as had been the previous position under the common law, because that formed the first stage of the procedure. It would be wrong to embark upon a mini trial of the action. (*Fanmailuk.com Ltd v Cooper* [2008] EWHC 2198 (Ch), [2008] B.C.C. 877 applied.) However at the second stage something more than a prima facie case was required: the court would have to form a view on the strength of the claim in order properly to consider the requirements of s.263. As the action had yet to be tried the view would be a provisional one. In particular in this case s.263(2)(a) and s.263(3)(b) required to be considered. Section 263(2)(a) applied a mandatory bar on derivate claim only where the court was satisfied that no director acting in accordance with s.172 would seek to continue the claim. (*Airey v Cordell* [2007] EWHC 2728 (Ch); [2007] B.C.C. 785 and *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch); [2008] B.C.C. 885 applied.)

H8. 3. Factors which a director acting in accordance with s.172 would consider included: the size of the claim; the strength of the claim; the cost of the proceedings; the company's ability to fund the proceedings; the ability of the potential defendants to satisfy a judgment; the impact on the company if it lost the claim and had to pay its own costs and the defendant's as well; any disruption to the company's activities while the claim was pursued; whether the prosecution of the claim would damage the company in other ways (e.g. by losing the services of a valuable employee or alienating a key supplier or customer) and so on. The weighing of all these considerations was essentially a commercial decision, which the court was ill-equipped to take, except in a clear case.

H9. 4. If some directors would, and others would not, seek to continue the claim, s.263(3)(b) should be applied, when many of the same considerations would apply. As a matter of strict legal right, B and W had been entitled to rescind or terminate the agreement when they had done so. Westrip's board had taken and followed counsel's advice on that matter. No criticism could be legitimately levelled at the board re re-transferring the shares in Rimbal to B and W. It was impossible to say that

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it had been negligent or in breach of duty in doing so. Further, if the old board, including the first applicant, had done what the agreement required it do, there would have been no question of rescission. This was clear case in which the strength of the claim against the board was so weak that no director, acting in accordance with s.172, would seek to continue the claim against the directors in respect of their actions in accepting the rescission. Alternatively, a person acting in accordance with s.172 would attach little weight to continuing it under s.263(3)(b).

H10. 5. The restitutionary claim contained no allegation of breach of duty by a director. It was thus not a derivative claim as pleaded and would have to be brought, if at all, pursuant to an order of the court made in proceedings under s.994 for unfairly prejudicial conduct as envisaged by s.996(2)(c) which authorised civil proceedings being brought in the name and on behalf of the company by persons the court directed.

H11. 6. The best course of action, exercising the powers in s.261(4)(c), was to direct the board to reconsider Westrip's defence to Rimbal's claim for substitution, on the basis that there might be a strong claim that Westrip held the licence on trust. If the board decided to defend that claim, there would be no need for a derivative action.

H12. 7. On some miscellaneous matters, a derivative claim was brought in good faith (a matter for the court to take into account under s.263(3)(a)) if the claimant brought the claim for the benefit of the company even if there were other benefits which would derive from the claim: here the dominant purpose of the action was to benefit Westrip. (*Nurcombe v Nurcombe* (1984) 1 B.C.C. 99,269; [1985] 1 W.L.R. 370 and *Barrett v Duckett* [1995] B.C.C. 362 applied.) If the rescission claim had been allowed to proceed, I would not have been regarded as a proper claimant as having participated in the wrong of which he complained, for on one view the real case of Westrip's loss was not the new board's failure to investigate a possible defence, but the old board's failure to follow steps which led to the new board finding itself in the predicament that it did. (*Nurcombe v Nurcombe* (above) applied.) The availability of an alternative remedy was not an absolute bar to a derivative claim: if it were then it would have been a mandatory ground for refusing permission under s.263(2) rather than a discretionary consideration for the court under s.263(3)(f). From the point of view of the company itself a petition under s.994 was far preferable, principally because it would only be a nominal party and would not incur legal costs, whereas in the ordinary way if a derivative action was brought for its benefit, it would be liable to indemnify the claimant against his costs, even if the claim was unsuccessful, and the potential liability of the company for costs was a proper consideration for the court in deciding whether to allow a derivative claim to proceed. In the present case the combination of that potential liability and the availability of an alternative remedy under s.994 would have led to the conclusion that if the application so far as it related to the trust claim had not been adjourned, it would not have been appropriate to allow the derivative claim to proceed. In relation to the court having "particular" regard under s.263(4) to the views of members of the company who had no personal interest, direct or indirect, in the matter, it must be as satisfied as it can be on an interim application that they were not financially interested in the outcome (beyond their interest as shareholders in the company).

H13. Cases referred to:

Airey v Cordell [2007] EWHC 2728 (Ch); [2007] B.C.C. 785
Barrett v Duckett [1995] B.C.C. 362
Central Estates (Belgravia) Ltd v Woolgar [1972] 1 Q.B. 48
DPR Futures Ltd, Re (1989) 5 B.C.C. 603; [1989] 1 W.L.R. 778
Fanmailuk.com Ltd v Cooper [2008] EWHC 2198 (Ch); [2008] B.C.C. 877

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Foss v Harbottle (1843) 2 Hare 461
Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Ch); [2008] B.C.C. 885
Godden v Merthyr Tydfil Housing Association (1997) 74 P. & C.R. D1
Goldsmith v Sperrings Ltd [1977] 1 W.L.R. 478
Jaybird Group Ltd v Greenwood [1986] B.C.L.C. 319
Konamaneni v Rolls Royce Industrial Power (India) Ltd [2003] B.C.C. 790; [2002] 1 W.L.R. 1269
Little Olympian Each-Ways Ltd, Re [1994] B.C.C. 959
Lowe v Fahey [1996] B.C.C. 320
Nurcombe v Nurcombe (1984) 1 B.C.C. 99,269; [1985] 1 W.L.R. 370
Prudential Assurance Co Ltd v Newman Industries Ltd (No.2) [1982] Ch. 204
Shah v Shah [2001] EWCA Civ 527; [2002] Q.B. 35
Smith v Croft (1986) 2 B.C.C. 99,010; [1986] 1 W.L.R. 580
Smith v Croft (No.3) (1987) 3 B.C.C. 218
Wallersteiner v Moir (No.2) [1975] Q.B. 373

H14. *John Wardell QC* and *Elizabeth Weaver* (instructed by Withers LLP) for the claimants.
Michael Todd QC and *Ruth Holtham* (instructed by Farrer & Co) for the first, fourth and fifth defendants.
Peter de Verneuil Smith (instructed by SC Andrew LLP) for the second, third, sixth and seventh defendants.

JUDGMENT

LEWISON J.:

Introduction

1. Mr Dimitri Iesini and his co-claimants are shareholders in Westrip Holdings Ltd ("Westrip"). They say that the defendants (other than Westrip itself) have deliberately engaged in a course of conduct which has led to Westrip losing ownership and control of a very valuable mining licence and which, but for their intervention, would have led to Westrip losing all or almost all of its remaining assets. They say that the course of conduct that they allege amounts to breaches of duty by the individual defendants. They apply to the court under s.261 of the Companies Act 2006 for permission to continue a derivative claim on behalf of Westrip in which they claim to reverse the alleged asset stripping and also claim declarations about Westrip's ownership of certain assets.

Background facts

2. Rimbal Pty Ltd ("Rimbal") is an Australian company beneficially owned by Mr Gregory Barnes ("Mr Barnes"). Mr Barnes is a geologist experienced in mining. In May 2001 the Government of Greenland Bureau of Minerals and Petroleum granted Rimbal an exclusive exploration licence for an area in West Greenland. This licence has been referred to as the Tanbreez licence. The Tanbreez area is thought to contain substantial quantities of valuable and rare metals. These include zirconium (used in high tech products), tantalum (used in capacitators to slow electrical charges), niobium (used in steel alloys), uranium and rare earths. The Tanbreez licence, however, does not allow these metals to be extracted (for which a further licence will be necessary) and, moreover, the terrain is such that

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extraction poses serious practical problems. Nevertheless, it is common ground that the Tanbreez licence is a very valuable asset. In 2007 it was valued at $900 million.

3. Westrip was formed as a vehicle to raise and provide the funding for the development of this mineral exploration licence. It is a company incorporated in England and Wales. Until a boardroom coup in June 2008 Mr Iesini was a director of the company, together with (among others) Mr Barnes and Ms Janine Walker. His brother, Mr Giacobbe Iesini (the second claimant) was also a director of the company from about March 2006 until the boardroom coup. Westrip contracted with Rimbal on the terms of two licences, referred to respectively as the "2002 licence" and the "2004 licence". The shareholders of Rimbal at the time were Mr Barnes and Ms Walker (but Ms Walker held her single share as Mr Barnes' nominee). Under the terms of the 2002 licence:

(i) Westrip was to control the management and implementation of the scheme for the development of the licensed areas (or "tenements");
(ii) Rimbal assigned to Westrip all of its present and future rights to all profits arising from any exploitation of mineral deposits within the tenement;
(iii) if Westrip paid £2.5 million, 51 per cent of Rimbal's shares would be transferred to Westrip (although it is difficult to see how Rimbal itself could have procured the transfer of its own shares);
(iv) the term of the 2002 licence was two years from May 2002; and
(v) the agreement was governed by English law.

4. The 2004 licence was in the same terms, except that the period of the licence was three years from July 2004.

5. In fact Westrip made no payment under the terms of either licence, so no shares in Rimbal were transferred.

6. In 2006 Rimbal acquired (or "pegged") another exploration licence for a different area of Greenland. This licence was originally number 2005/17. In 2007 the area covered by the 2005/17 mineral exploitation licence was subdivided into "the Northern Licence" (also known as the "Kvanefjeldt Licence") which is Licence No. 2005/28, and "the Southern Licence" which is Licence No. 2005/29. The application for subdivision was made in January 2007 and granted on May 1, 2007.

7. In 2006 Westrip had agreed in principle with Mr Barnes and Ms Walker for the purchase of their shares in Rimbal. It was envisaged that the consideration for the purchase would be the allotment of redeemable preference shares in Westrip. An extraordinary general meeting (EGM) of the members of Westrip took place on June 10, 2006. One of the matters discussed was the proposal to allot £2.5 million of redeemable preference shares. The minutes of the meeting recorded:

> "These shares are being allotted to Greg [Barnes] and Janine Walker in consideration of transferring Rimbal to Westrip as a wholly owned subsidiary. The transaction will be contemporaneous with the sale of a separate licence to Uranium Resources and issue of shares in the ultimate public quoted company seeking to acquire Uranium Resources. The Members' and company interests will be protected at all times by funds and shares being held in escrow …
> With Greg and Janine Walker exclude[d] from voting, the proposal was agreed by more than 76per cent and therefore special resolution was passed …"

8. The formal resolution stated:

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"The following resolution was passed: 1. To issue 2,500,000 redeemable preference shares without voting, dividend or winding up rights."

9. At the time, however, Westrip's articles of association did not allow for the issue of redeemable preference shares.

10. By this time Westrip had agreed terms for a joint venture to exploit the Northern Licence with an Australian company called Greenland Minerals and Energy Ltd (always referred to as "GGG" which is its Australian stock exchange acronym). The essential terms of the joint venture were that Westrip would sell a 61 per cent share in the Northern Licence in return for AUD$3 million and the issue of 30 million shares in GGG.

11. On January 18, 2007, the board of Westrip met. It was reported that Mr Barnes had agreed to sell Rimbal for £500,000 in cash and £2 million in "non-coupon redeemable preference shares". The board resolved to present the agreement to an EGM. The EGM took place on January 25, 2007. A number of resolutions were placed before the meeting as ordinary resolutions. Among those which were passed was a resolution:

"that the ordinary shares of Rimbal Pty Ltd be acquired on the terms set out in Annex 3 and it is further resolved that Simon Stafford-Michael have the authority to negotiate the final wording of the contract and execute all such documents necessary for the closure of such transaction."

12. Annex 3 recorded that the consideration for the purchase was to be £500,000 and the allotment of 2 million redeemable non-interest non-convertible bearing preference shares. The other terms of acquisition were contained in heads of terms which were supplied to the EGM.

13. On February 28, 2007, Westrip entered into two more or less identical agreements; one with Mr Barnes and Ms Walker and the other with Ms Walker alone. These agreements are at the heart of the dispute. It is necessary to set out their terms which I do by reference to the agreement between Westrip and Mr Barnes and Ms Walker. The agreement (the "SSA") began with a number of recitals. It referred to the 2002 Licence; it recited that Rimbal had granted Ms Walker a 50 per cent interest in Exploration Licence 2001/08 which she had "rolled over" into Horrocks Enterprises Pty Ltd ("Horrocks") a company all of whose issued shares she owned. Recital F said:

"Although Exploration Licence 2005/17 was granted in the name of [Rimbal], [Rimbal] holds it on trust for [Westrip]. [Westrip] paid for this Exploration Licence to be pegged and has met the minimum expenditure requirements to ensure that this Exploration Licence is maintained in good standing."

14. The recitals continued by saying (among other things) that Ms Walker was to enter into an agreement on substantially the same terms to sell her shares in Horrocks. Clause 2 of the SSA contained the agreement for sale and purchase. The purchase consideration was defined by the schedule to the SSA as £1,250,000 in cash or 1,250,000 redeemable shares of £1 each in the capital of Westrip. The terms of the redeemable shares were also set out in the schedule. Clause 3 set out a number of conditions which had to be satisfied before the settlement date. In the first instance the settlement date was March 14, 2007 (although this was later extended). The vendor and purchaser were to negotiate in good faith and agree the form of certain company documents. These included a notice convening an EGM proposing a special resolution to adopt certain articles of association permitting the allotment and issue of redeemable preference shares on the terms set out in the schedule to the SSA; and a resolution adopting those articles. Westrip's directors were to resolve to convene the EGM; and to send the relevant documents to those who were entitled to receive them. Westrip was

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to hold the EGM and the special resolution adopting the articles was to have been passed. Westrip was to send a copy of the special resolution and the articles to the Registrar of Companies; and the members of the company were to waive any rights of pre-emption. All these steps were set out in meticulous detail. Clause 3(2) provided that:

> "The conditions in clause 3 (1) are for the benefit of the Vendor and may only be waived by the Vendor."

15. Clause 4 set out what was to happen "at settlement". In particular cl.4(a) required Mr Barnes and Ms Walker to deliver share certificates in Rimbal "against consideration of the Purchase Consideration"; and cl.4(d) required the directors of Westrip to adopt a resolution allotting and issuing and to cause to be allotted and issued the redeemable preference shares. Again, all these steps were set out in meticulous detail.

16. There were a number of other relevant terms of the SSA. These included:

(i) cl.6 provided that time was of the essence of the contract;
(ii) cl.10.1 contained a warranty by Westrip (which was to be correct both at the date of the agreement and at the date of settlement) that the redeemable preference shares had been validly allotted and issued;
(iii) cl.19 provided that in the event of any breach of the agreement by Westrip Mr Barnes and Ms Walker would be entitled "to rescind" the agreement and to exercise the option to retain the shares in Rimbal and sue for damages; and
(iv) cl.21 provided that any waiver of rights under the agreement was not to have any effect unless made in writing and executed by the party whose rights were waived.

17. The terms on which the redeemable preference shares were to be issued were set out in the schedule to the agreement. In short they were to be redeemable at par six months after the settlement date. They were to carry the right to be paid the redemption amount in priority to other shareholders in the event of a winding up; but otherwise were to carry no entitlement to participate in the profits or assets of Westrip. If the shares were not redeemed on the due date, the holders of the shares were entitled to convene a general meeting of Westrip and pass a resolution for its winding up. The fact that the redeemable preference shares which the SSA required were to have rights in a winding up meant that the special resolution that had been passed back in June 2006 did not authorise the issue of compliant preference shares.

18. On March 2, 2007, Mr Tony Martin of Westrip's then company secretary, Mark Law Registrars Ltd, circulated a written resolution to all shareholders in Westrip. In his covering email he said:

> "In addition and just as important is the attached written resolution regarding the issue of preference shares at an extraordinary meeting of the company on 10 June 2006. At that time, we neglected to cover the aspect of shareholder rights in specific detail. In simple terms this makes the "Rimbal" agreement happen smoothly and gives Westrip ownership of the licences, through owning 100 per cent of Rimbal."

19. The resolution to which all the shareholders consented was, however, no more than a waiver of pre-emption rights to which they were entitled under the articles. The resolution did not change the terms on which preference shares could be allotted and issued. Thus Westrip was still not able to issue compliant preference shares.

20. On March 6, 2007, Mr Barnes and Ms Walker transferred their shares in Rimbal to Westrip. The SSA had envisaged that these shares would be transferred on the settlement date in exchange for

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the issue of the redeemable preference shares in Westrip, but in fact Mr Barnes and Ms Walker transferred them before they were obliged to do so; and they did not transfer the shares in exchange for the purchase consideration. On the contrary, they transferred the shares for no consideration at all.

21. On March 13, 2007, in consideration of AUD$1, Mr Barnes and Ms Walker agreed to extend the settlement date under the SSA to April 11, 2007.

22. On the following day, March 14, 2007, Rimbal, Westrip and Broadstone Resources Ltd ("Broadstone") entered into an agreement called the "Side Deed". It recited that the Exploration Licence (defined as Exploration Licence 2005/17) was held by Rimbal "a wholly owned subsidiary of Westrip". This licence is not the Tanbreez licence which Rimbal held in its own right. The recited purpose of the Side Deed was for Rimbal to give certain assurances in relation to the Exploration Licence. By cl.2.1(c) Rimbal represented and warranted to Westrip and Broadstone that "the Westrip Contractual Rights are valid and in full force and effect". The Westrip Contractual Rights were defined as:

> "… Westrip's rights to, inter alia, promote and develop the Exploration Licence by virtue of Rimbal holding upon trust for, and as nominee of, Westrip as owner of the full, absolute and entire beneficial interest in the Exploration Licence."

23. On the same day Westrip entered into a joint venture agreement with Broadstone. The joint venture agreement recited that Exploration Licence 2005/17 was:

> "presently held by a wholly owned subsidiary of Westrip ('Subsidiary') and by virtue of Subsidiary holding upon trust for, and as nominee of, Westrip as owner of the full, absolute and entire beneficial interest in the Existing Exploration Licence, Westrip is entitled to enter into this agreement."

24. The joint venture agreement allocated percentage interests in the joint venture to the two joint venture parties, with options granted to Broadstone to enlarge its percentage interest on making certain payments. By virtue of a series of subsequent deeds and novations, to which Rimbal was also a party in order to confirm the warranties given by it in the side deed, GGG now occupies the position of Broadstone as joint venturer. On the face of it is seems plain that the parties to the joint venture relied on Rimbal's warranties in entering into their arrangements.

25. In March 2007 Mr Barnes resigned as a director of Westrip.

26. On April 18, 2007, Westrip's lawyers, Jackson McDonald, prepared a checklist of the steps that Westrip needed to take in order to comply with the SSA insofar as it related to the allotment and issue of the redeemable preference shares. This checklist was never implemented.

27. On about June 8, 2007, by the second variation agreement, Mr Barnes and Ms Walker extended the settlement date under the SSA for the second time, to June 15, 2007, conditional upon Westrip having received $5 million under a royalty agreement entitling Westrip to that money. The consideration for this extension was (among other things) Westrip's agreement to pay Mr Barnes £150,000 in cash on receipt of the $5 million "in lieu of the right to redeem" the preference shares up to an amount equal to £150,000. Westrip's board had in fact resolved to make payments of £150,000 each to Mr Barnes and Ms Walker the day before, having received the $5 million under the royalty agreement. The board's decision was minuted as follows:

> "… it was agreed that payments of £150k be made forthwith to Gregory Barnes & Janine Walker under the terms of the Share Purchase Agreements (and latest draft Variations thereto)."

28. The payments to Mr Barnes and Ms Walker were made on June 12, 2007. At the time the precise character of the payments was not documented. That came later in January 2008. The remainder of the $5 million was used for the development of Tanbreez.

29. On June 14, 2007, following the passing of a special resolution at an EGM, Westrip at last adopted new articles of association enabling the directors to allot and issue compliant redeemable preference shares. The redeemable preference shares were to be redeemed at £1 per share on September 30, 2008. There were other terms attached to these shares. It is common ground that if shares had been allotted and issued under these articles, they would have complied with the requirements of the SSA.

30. The joint venture agreement was completed on about August 16, 2007. GGG, having assumed the rights and obligations of Broadstone, paid AUD$500,000 to Westrip and issued to it 30 million shares. This was the consideration for GGG's participation in the joint venture which, it will be recalled, was for the exploitation of Licence 2005/17 (which by now had been split into the Northern and Southern Licences); not the exploitation of the Tanbreez licence.

31. On September 29, 2007, Westrip held its annual general meeting (AGM). One of the agenda items was the adoption of the company's financial statements for the year ended January 31, 2007. Those financial statements were duly adopted. The significance for present purposes of that is that the financial statements contained the following note under the heading "Post balance sheet events":

> "The company acquired 100 per cent of ownership of Rimbal … on 14 June 2007 at a cost of £2,500,000. The transaction was funded by shareholder resolution of redeemable preference shares to that value."

32. On December 13, 2007 Mr Stafford-Michael and Mr Sharp prepared a memorandum about Westrip's progress and financial position. They concluded that Westrip had a need for $20 million working capital and also a need for an additional $10 million of capital. Part of the additional capital was needed "to redeem outstanding [preference] shares issued in connection with the acquisition of Rimbal Pty Ltd."

33. On January 4, 2008, Westrip's board passed an ordinary resolution authorising the company to redeem 300,000 preference shares at par. The shares were to be redeemed out of the company's capital; and Westrip's directors (with the exception of Ms Walker) completed a declaration on form 173. At the same time Westrip submitted a return to Companies House notifying its purchase of 300,000 shares. The annual return that Westrip submitted to Companies House on January 16 showed Mr Barnes and Ms Walker as each being the holder of 1,100,000 redeemable preference shares (i.e. the original 1,250,000 less the shares apparently redeemed). The desired effect of this seems to have been to characterise the payments that had been made back in June 2007 as having been made in partial redemption of the preference shares.

34. Mr Barnes was a director of another Australian mining company, and in that capacity had become embroiled in proceedings in Australia. It was those and associated proceedings that had triggered his resignation from the board of Westrip nine months earlier. Westrip sought legal advice on what Mr Barnes' ongoing role in the company should be. On February 15, 2008, Morgan Lewis, US lawyers, advised that Mr Barnes should, in effect, take a back seat during the pendency of the Australian proceedings. They gave their advice on the basis on a number of assumption, recorded in their letter of advice, one of which was:

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> "Mr Barnes is a founding shareholder of the Company, holding an approximately 15.0 per cent voting stake, with additional preference shares which may be redeemed in or about September 30, 2008 …"

35. Mr Barnes was sent a copy of their advice on March 10, 2008, or thereabouts. Shortly thereafter Westrip's board split into two camps. Each camp was, at least on the face of it, engaged in attempting to raise finance for Westrip. Mr Schønwandt, the chairman of the board, led negotiations with Weyhill Establishment to which he had been introduced by Ms Moss of Vera Ltd. On April 16, 2008, Mr Sundell, the chief executive officer (CEO) of Weyhill, wrote to Mr Schønwandt. He said that Weyhill had two areas of particular concern. The first was that the funding be made through a new company to be domiciled in Liechtenstein, which would become Westrip's holding company. This new corporate entity would be run by Mr Schønwandt and Mr Barnes. The second was the management of Westrip. Mr Sundell said that Mr Stafford-Michael and Mr Scanlon (who was then the managing director) must leave the board and that a new managing committee should be formed to administer the company in Perth. There was a board meeting of Westrip on the same day. Mr Schønwandt reported to the board that Mr Sundell had offered funding on the security of Westrip's GGG shares; and that among the terms were that Mr Stafford-Michael and Mr Scanlon must leave the board. He added that he had "received feedback" from several members purporting to represent a majority that the board should resign en masse. After discussion the board resolved to meet again on April 23 and to convene an EGM on May 7.

36. On May 5, 2008, Mr Schønwandt and Mr Sharp wrote to all the members of Westrip. They said that they had come to an agreement with Weyhill for the provision of $20 million interim debt facility secured on Westrip's GGG shares. Weyhill would also require a charge over the company holding the Tanbreez licence (i.e. Rimbal). Interest would be payable at less than 15 per cent. They also referred to the management changes that Weyhill required. The letter continued by saying that more than 60 per cent of the members had asked that the entire board resign, and stated:

> "I have been informed that Greg Barnes has requested an EGM to accomplish these changes in lieu of voluntary resignations and that he currently holds proxies, including his own shareholding, that represent approximately sixty seven per cent of the outstanding Westrip shares. This overwhelming majority makes it very likely that Westrip will be able to make the required changes and move to closing the interim funding."

37. A term sheet for the Weyhill loan, of the same date, reflects these terms. The letter did not mention the proposal for a new holding company to be formed in Liechtenstein. But the term sheet does not mention the proposal for a new holding company to be formed in Liechtenstein either. At some stage however (the date is not clear) two Liechtenstein foundations were established (or proposed to be established: again it is not clear which). The laws (or draft laws) of each foundation named the beneficiaries of the foundation. One foundation, to be called the Qaqortoq Foundation listed among its beneficiaries Westrip (25 per cent), Mr Barnes (10 per cent) Mr Read (9 per cent) Mr Powar (9 per cent) Mr Sharp (9 per cent) Ms Walker (4 per cent) Mr Schønwandt (1 per cent) Mr Bosme (1 per cent) and Mr Kasserer (1 per cent). The other, to be called Westriver Foundation, listed the same individuals among its beneficiaries, but not Westrip. The laws (or draft laws) stated that each beneficiary had the right to claim the assets of the foundation.

38. The purpose of the foundations is obscure. Mr Iesini says:

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> "The original plan was to use Westrip's GGG shares to raise £20 million. This £20 million would be used to create two highly leveraged hedge funds which would raise sufficient monies to be able to fund Westrip's needs. In other words, the only capital introduced at the first stage was going to come via Westrip's shares in GGG other than the £250,000 borrowed from Westrip."

39. Mr Iesini goes on to say that the two hedge funds "would operate through" the two Liechtenstein foundations. How they would "operate through" the two foundations remains obscure. Mr Read, who is one of Mr Iesini's co-claimants, and was to be a beneficiary of the foundations, has given no evidence.

40. The circular letter of May 5, 2008, was followed by a lively email debate among Westrip's members about the merits of the Weyhill offer. The position of the supporters of the offer was put by Mr Sharp:

> "WE ARE BROKE, WE ARE ON THE BRINK OF INSOLVENCY. If we don't put up the collateral that we have then we will not get finance from anyone."

41. On May 15, 2008, Mark Law Registrars Ltd resigned as Westrip's company secretary. On May 23 an electronic copy of Westrip's share register was made. It did not contain any record of redeemable preference shares having been issued to Mr Barnes or Ms Walker.

42. Meanwhile Mr Iesini was in discussion with Mr Shamazian of Exchange Minerals Ltd as an alternative potential funder. By the end of May 2008 there was a draft agreement in existence. Under the terms of the draft Exchange Minerals would provide a facility of AUD$20 million, bearing interest at 9.5 per cent per annum (but compounded monthly), secured by a first fixed and floating charge. Among the other terms of the draft were a right for the lender to nominate three members of the board, one of whom was to be the chairman. A board meeting took place on May 30. Mr Schønwandt refused to discuss the proposed facility offered by Exchange Minerals and left the meeting. The remaining board members discussed the Exchange Minerals offer. Mr Stafford-Michael pointed out that the company was on the verge of insolvency and that the directors were bound to consider all offers made. In the course of the meeting Mr Barnes telephoned in and made forceful comments (the contents of which are not recorded in the minutes, although Mr Iesini's evidence is that Mr Barnes spoke against the Exchange Minerals offer). The upshot of the meeting was that the board decided to put both the Exchange Minerals offer and the Weyhill offer before the company in general meeting.

43. An EGM took place on June 9, 2008. The principal item before the meeting was a motion to remove the board, with the exception of Mr Schønwandt and Ms Walker. The motion was supported by Mr Barnes. In the course of the discussion he was asked whether it was his intention to insist on being paid for his preference shares in September. He replied that he had made it clear at previous meetings that he was prepared to extend that time in the interests of the company and accordingly would not exercise that option in the near future. The vote was then held and the motion to remove the board was passed. Mr Barnes, Mr Powar and Ms Walker were appointed as new directors, and Mr Schønwandt continued as chairman of the board. Mr Powar had declared an interest as a senior vice president of Weyhill. It was also pointed out that Mr Read was also a vice-president of Weyhill.

44. Later that day a second part of the EGM was held to discuss funding options. Mr Stafford-Michael is recorded in the minutes as having said that with the change of board members the Exchange Minerals offer was now redundant; and that the Weyhill proposals were the only offer now on the table. Mr Iesini says in his evidence that he had expected Mr Shamazian to attend the EGM to explain the Exchange Minerals offer to the shareholders, but that he failed to appear and gave no explanation. Mr Iesini says that Mr Stafford-Michael subsequently told him that the reason

why Mr Shamazian did not come was because Mr Barnes had told him that Westrip had already raised $20 million and no longer needed Exchange Mineral's funds. This is third or fourth hand hearsay. Mr Barnes denies having said this to Mr Shamazian. He says that he discussed the situation with Mr Shamazian and the possibility that the board might put Westrip into liquidation; and that, as a result of the discussion, Mr Shamazian decided not to attend the EGM. It is impossible to decide where the truth lies, but the minutes of the meeting do not support Mr Iesini's account. Moreover, Mr Iesini did not himself attend the second part of the meeting. If he had expected Mr Shamazian to attend it (and was unaware of his decision not to attend) that seems very surprising. Even if Mr Shamazian did not attend the meeting personally, the Exchange Minerals offer, if still on the table, could have been put to the meeting. At all events, again for reasons that are obscure, the Weyhill offer did not proceed; and negotiations with Exchange Minerals were not re-opened.

45. On June 23, 2008, Mr Barnes sent a letter to the directors and shareholders of Westrip. He said that in September a payment of £2.1 million would be due for the purchase of Rimbal and that "if payment is not made Rimbal reverts back to the original owners". He also said that the sale of the Northern Licence had not been a good deal for Westrip, chiefly because it had left Westrip with a tax bill of $3 million. He and the board were working to find a solution.

46. On July 24, 2008, the board suspended Mr Iesini from his duties with the company on the ground that he had been in breach of contract and in breach of his fiduciary obligations to Westrip. No details of the allegations were given at the time or subsequently.

47. Despite the resignation of Mark Law as Westrip's company secretary, it still retained the company's records. The board made a number of written requests for the books and records during the summer of 2008; but they were not produced to the company's lawyers until September 25, 2008 (a Thursday), some five days before the redemption date of the preference shares that were to have been allotted and issued under the SSA. At some stage before the handover of the books and records the share register was retrospectively altered. The alteration purported to show that redeemable preference shares had been issued to Mr Barnes and Ms Walker on April 30, 2007. Why April 30 was chosen as the date remains a mystery. The records handed over also included draft unsigned share certificates also bearing that date. The records handed over also purported to show a partial redemption of those preference shares.

48. If preference shares compliant with the SSA had been issued, the redemption date was fast approaching. Westrip did not have the money to redeem the shares. This was pointed out by, among others, Mr Stafford-Michael in a letter circulated to shareholders on September 15, 2008. That was the very day on which Lehman Brothers collapsed. The prospects of raising large sums of cash at short notice were not promising. As Mr Schønwandt put it in evidence:

> "It was not the moment to be trying to find £2.2 million plus funding for further development costs against a long distant hoped-for profits stream. The board concluded that not only could Westrip not make any payment to Mr Barnes or Ms Walker, but further, it could not approach them with any meaningful proposal to make payment in the future."

49. The board embarked on inquiries to determine whether compliant preference shares had in fact been issued. During the course of investigations made over September 29 and 30, it was discovered that the steps required to allot and issue the shares (which had been clearly set out in the SSA) had not in fact been taken. The board decided to instruct counsel (Mr Alan Boyle QC and Mr Richard Walford) to advise. They advised in consultation on September 30, and recorded their advice in a written note. They pointed out that the board's efforts to ascertain the relevant facts had been hampered by difficulties in obtaining Westrip's books and records from its former company secretary. Mr Boyle

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and Mr Walford were themselves only instructed late on September 29; and the material with which they were supplied was itself supplemented during the course of the consultation as more information became available. They summarised the two key issues:

(i) whether Westrip had complied with its obligations under the SSA to create and allot compliant preference shares to Mr Barnes and Ms Walker; and
(ii) if not, whether there were any steps that Westrip could take to rectify the situation so as to preserve for Westrip its interest in Rimbal and Horrocks and the value of the underlying mineral licences.

50. Having gone through the facts as they appeared, counsel concluded that "the simple and straightforward points" were:

(i) prior to June 14, 2007, no purported allotment of redeemable preference shares could have been valid; and
(ii) after that date, there was no evidence of any actual decision by the board of directors to make such an allotment.

51. The first consequence of these conclusions was that Westrip had been in breach of a number of its obligations under the SSA since June 15, 2007, and that the vendors had a right to rescind. Counsel then considered whether the breaches could be remedied by the late allotment of compliant preference shares. They concluded that it was unlikely that this could be done, not least because under the terms of the company's articles, the redemption date for the shares had arrived; and time was of the essence of the SSA. They concluded, therefore, that if a remedy was to be found it would require a further agreement by Mr Barnes and Ms Walker to extend time for settlement and to a change in the terms of the preference shares postponing the redemption date as well as a change to the company's articles of association to enable new preference shares to be issued. They advised therefore that Mr Barnes and Ms Walker should be asked for their agreement and also advised that advice should be taken from Western Australian lawyers.

52. On October 2 Westrip wrote to Mr Barnes and Ms Walker. The letter pointed out all the defects in the internal steps that Westrip had taken to issue redeemable preference shares. It did not attempt to put any "spin" on Westrip's failures. But, as advised, the letter did ask for Mr Barnes' and Ms Walker's agreement to a further extension of time. Since Mr Barnes and Ms Walker were directors of Westrip and therefore knew what advice had been given, any "spin" would probably have been pointless.

53. On October 7 Westrip received advice from Mallesons, Western Australian lawyers. Their advice was that the advice given by Mr Boyle QC and Mr Walford was consistent with Western Australian law; and that, based on the known facts, Mr Barnes and Ms Walker were entitled to rescind.

54. On the following day, October 8, 2008, Mr Barnes and Ms Walker gave notice exercising their right to rescind under cl.19 of the SSA. They also asserted a right to have the Rimbal shares re-transferred to them. Morgan Lewis immediately sent a copy of that letter to Mallesons and asked whether it was appropriate for Westrip to comply with their demands or whether there was "some other action or defence Westrip needs to take." Mallesons' advice, given on October 10, was that although the right to terminate in case of breach of contract was not absolute, "the available facts favour Barnes & Walker". They further advised that it would be difficult for Westrip to satisfy an Australian court that Mr Barnes or Ms Walker had breached their good faith obligations or engaged in unconscionable conduct in circumstances where they had substantially complied with their

obligations under the SSA; and where the £150,000 paid to them was paid to secure variations to the SSA and was separate from the SSA itself.

55. The Westrip board met on October 10. Two lawyers were in attendance. The meeting considered the legal advice that had been given both in England and Australia and concluded that Mr Barnes and Ms Walker did have the right to rescind and that although it was not certain that a Western Australian court would grant specific performance it was "hugely likely". Based on that conclusion the board resolved to execute the share transfer forms relating to Rimbal and Horrocks. In short, the board accepted that the SSA had been validly rescinded.

56. In December 2008 Westrip consulted senior and junior counsel in Australia on the question whether licence 2005/17 (subsequently split into the Northern Licence and the Southern Licence) was held by Rimbal on trust for Westrip. Instructions on the facts were given to counsel by Mr Barnes, Ms Walker and Mr Sharp. Clearly it was in Mr Barnes' interest as the shareholder in Rimbal for there to be no trust. Ms Walker had the same interest. There was therefore a clear conflict of interest between Westrip on the one hand, and Mr Barnes and Ms Walker on the other. Counsel were provided with a number of documents. These included the SSA (which contained recital F reciting the trust) the joint venture agreement between Westrip and Broadstone (which did likewise) and the side deed made between Rimbal, Westrip and Broadstone (by which Rimbal warranted the existence of the trust). They recorded that in their discussions with Mr Barnes he had vehemently denied that Rimbal had agreed to hold the licence on trust for Westrip. But counsel noted that both Mr Barnes and Ms Walker had signed the SSA which contained an acknowledgement of the trust. They briefly recounted the history of the other documents, including the joint venture agreement and the side deed. They recorded that they had been asked to advise on the question whether the arrangements between Westrip and Rimbal amounted to the creation of a trust over licence 2005/17; and, if not whether the arrangements otherwise amounted to the acquisition of a proprietary interest by Westrip. They concluded that there was no evidence to suggest that, as a matter of Australian law, there was a declaration of trust by Rimbal. Nor was there a basis for considering that Westrip acquired some other proprietary interest in the licence. In reaching that conclusion they considered recital F in the SSA which they said did not amount to a declaration or acknowledgment of trust by Rimbal (which was not a party to the SSA). They considered that although the side deed suggested that such a trust already existed it fell short of a declaration of trust and did not create any proprietary rights.

57. On February 13, 2009, Rimbal's Australian lawyers wrote to Westrip. They asserted that as a result of the rescission of the SSAs there had been a total failure by Westrip to provide the consideration due under those agreements. The letter asserted that the purpose of the SSAs was to enable Westrip to obtain Licence 2005/17; and that it was as a result of having obtained the Rimbal shares that Westrip entered into the joint venture with Broadstone and later GGG. The letter went on to say that Westrip's share in the joint venture and its shares in GGG were held on trust for Rimbal as a result of the rescission.

58. On March 6, 2009, Rimbal issued a writ in Western Australia. It claimed a right to be substituted as a party to the joint venture agreement in place of Westrip, the recovery of moneys and benefits received by Westrip under the joint venture agreement and a transfer of Westrip's issued shares in GGG. Mallesons were consulted in May. Their letter of advice was dated May 15, 2009. It was addressed to the Westrip board, with copies to Mr Sharp and Mr Barnes. The letter recorded that they had been instructed by Mr Barnes (a director of the company) and Mr Sharp "(an external consultant to the Company with authority from the Board to act on the Company's behalf)". They set out the background to the dispute and the proposed settlement. Their advice was that:

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> "Rimbal has at least reasonable prospects of successfully pursuing the Company for remedies arising out of the Company's failure to issue Rimbal the redeemable preference shares … under the … [SSAs]"

59. They further advised that:

> "In circumstances where a court is likely to form the view (based on the materials presently before us) that the Company holds Exploration Licence Number 2005-17 on trust for Rimbal, it is our view that the terms are reasonable as it will involve a monetary settlement (in effect) of approximately AUD$8 million."

60. But they pointed out that it was a commercial decision for the board whether to settle on those terms. Curiously, in a letter dated September 23, 2009, Mallesons said that they had not received any instructions from Mr Barnes himself in late 2008 and early 2009 and that:

> "Accordingly, Mr Barnes' instructions cannot be said to have affected the advice given by Mallesons in relation to either the rescission of the SSAs or … the proposed settlement of CIV 1447."

61. The last part of this statement is difficult to reconcile with the opening of their letter of advice of May 15, 2009, which addressed the question of settlement. At some stage the board also saw a copy of the legal advice that Mr Barnes had obtained from Mr Grant Donaldson S.C. Mr Donaldson's view was that Westrip had no grounds for resisting Rimbal's claim. The proposed settlement of the action was in two stages: first a bi-partite settlement between Rimbal and Westrip and second a tri-partite settlement between Westrip, Rimbal and GGG. The second stage of the settlement has not been completed.

62. The claim form in this action was issued on June 26, 2009. On July 10, 2009, Norris J. considered the application to continue the derivative claim on paper and directed that the application proceed to the second stage of the statutory procedure. On July 27,. Proudman J. granted a freezing order over Westrip's 30 million shares in GGG and its interest in the Northern Licence. The freezing order also extended to Tanbreez.

The claimants' case

63. Mr Todd QC, appearing with Ms Holtham for Westrip, Mr Powar and Mr Schønwandt, complains with justification that the claimants' case has changed markedly from the case that was presented to Norris and Proudman JJ. The case as presented to me was heavily reliant on three strands:

(i) an allegation that the board of Westrip colluded in the rescission as part of a conspiracy to deprive Westrip of its assets;
(ii) an allegation that the board of Westrip were in breach of duty in failing to consider possible defences which Westrip might advance to challenge the rescission; in particular a defence that Mr Barnes and Ms Walker were estopped from alleging that compliant preference shares had not been allotted and issued in time; and
(iii) an allegation that, whether or not the rescission was effective, Westrip was and remains entitled to assert ownership of the 30 million GGG shares and to assert beneficial ownership of the Northern Licence on the ground that Rimbal held it on trust for Westrip.

64. Despite Mr Todd's grumbling, he was content to deal with the new case without an adjournment; and so will I.

Conspiracy

65. The draft amended particulars of claim allege that the following overt acts were carried out pursuant to the conspiracy:

(i) the creation of Weyhill, the Liechtenstein Foundations and the making of the Weyhill offer;
(ii) the use of the Weyhill offer to change the board of directors of Westrip;
(iii) the promoting and making of a false claim for rescission;
(iv) the acceptance of that claim by a board acting in breach of duty;
(v) the re-transfer of the shares in Rimbal and Horrocks to Mr Barnes and Ms Walker; and
(vi) the decision of the board not to defend the proceedings issued by Rimbal in Western Australia.

Estoppel

66. Although the draft particulars of claim allege that compliant redeemable preference shares were in fact allotted (in the sense that Mr Barnes and Ms Walker became unconditionally entitled to be entered on the register as holders of the shares), Mr Wardell QC, appearing with Ms Weaver for the claimants, rightly in my judgment did not press this allegation. It is plain that there are a variety of technical defects in Westrip's internal procedures which have the result that no compliant preference shares were allotted or issued before the redemption date; let alone before the settlement date. These defects were convincingly explained by Mr Boyle QC and Mr Walford; and convincingly supported by Mr Todd. However, the draft amended particulars of claim go on to allege that Mr Barnes and Ms Walker are estopped from asserting that no complaint redeemable preference shares were issued in time. The estoppel is alleged to arise from the following:

(i) budgets and spreadsheets produced by Westrip to show its financial position referred to the redeemable preference shares held by Mr Barnes and Ms Walker and the need to redeem them. Ms Walker was a director of Westrip at the time;
(ii) Westrip's financial statements for the year ended January 31, 2007, recorded that it had acquired ownership of Rimbal on June 14, 2006, at a cost of £2.5 million which it had funded by the issue of redeemable preference shares to that value. The financial statements were approved by the board on September 20, 2007, and at Westrip's AGM on September 29, 2007; and
(iii) in conversations in late 2007 and at Westrip's EGM on June 9, 2008, Mr Barnes and Ms Walker assured Westrip that they would not seek to redeem the remainder of the preference shares until further funds were available.

67. The draft amended particulars of claim go on to allege that Westrip acted on the common understanding that compliant redeemable preference shares had been allotted and issued in the following ways:

(i) Westrip paid £300,000 to Mr Barnes and Ms Walker in redemption of some of the redeemable preference shares;
(ii) Westrip incurred substantial expenditure in connection with Tanbreez; and
(iii) because of the assurances given by Mr Barnes and Ms Walker, Westrip committed its funds to the development of Tanbreez.

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The legal framework

68. The new procedure for derivative claims is now contained in the Companies Act 2006. Its broad outlines, although not every detail, follow the Law Commission's recommendations in their report on *Shareholders' Remedies* (Law Com. 246). Section 260 deals with the circumstances in which a derivative claim may be brought. It says:

> "(1) This Chapter applies to proceedings in England and Wales or Northern Ireland by a member of a company—
> (a) in respect of a cause of action vested in the company, and
> (b) seeking relief on behalf of the company.
> This is referred to in this Chapter as a 'derivative claim'.
> (2) A derivative claim may only be brought—
> (a) under this Chapter, or
> (b) in pursuance of an order of the court in proceedings under section 994 (proceedings for protection of members against unfair prejudice).
> (3) A derivative claim under this Chapter may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company.
> The cause of action may be against the director or another person (or both)."

69. Section 261 provides:

> "(1) A member of a company who brings a derivative claim under this Chapter must apply to the court for permission (in Northern Ireland, leave) to continue it.
> (2) If it appears to the court that the application and the evidence filed by the applicant in support of it do not disclose a prima facie case for giving permission (or leave), the court—
> (a) must dismiss the application, and
> (b) may make any consequential order it considers appropriate.
> (3) If the application is not dismissed under subsection (2), the court—
> (a) may give directions as to the evidence to be provided by the company, and
> (b) may adjourn the proceedings to enable the evidence to be obtained.
> (4) On hearing the application, the court may—
> (a) give permission (or leave) to continue the claim on such terms as it thinks fit,
> (b) refuse permission (or leave) and dismiss the claim, or
> (c) adjourn the proceedings on the application and give such directions as it thinks fit."

70. Section 262 deals with a different situation, namely where the proceedings have been brought by the company; and the claim could be pursued as a derivative claim. It enables a member to apply to the court for permission to continue the claim as a derivative claim on the ground (among others) that the company is not pursuing the claim diligently.

71. Section 263 of the Act sets out the circumstances in which the court is bound to refuse permission; and also contains a non-exhaustive list of the matters that the court must take into account in considering whether or not to give permission. It provides:

> "(1) The following provisions have effect where a member of a company applies for permission (in Northern Ireland, leave) under section 261 or 262.
> (2) Permission (or leave) must be refused if the court is satisfied—

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(a) that a person acting in accordance with section 172 (duty to promote the success of the company) would not seek to continue the claim, or
(b) where the cause of action arises from an act or omission that is yet to occur, that the act or omission has been authorised by the company, or
(c) where the cause of action arises from an act or omission that has already occurred, that the act or omission—
(i) was authorised by the company before it occurred, or
(ii) has been ratified by the company since it occurred.

(3) In considering whether to give permission (or leave) the court must take into account, in particular—
(a) whether the member is acting in good faith in seeking to continue the claim;
(b) the importance that a person acting in accordance with section 172 (duty to promote the success of the company) would attach to continuing it;
(c) where the cause of action results from an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—
(i) authorised by the company before it occurs, or
(ii) ratified by the company after it occurs;
(d) where the cause of action arises from an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company;
(e) whether the company has decided not to pursue the claim;
(f) whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than on behalf of the company.

(4) In considering whether to give permission (or leave) the court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter."

72. Since section 172 plays an important part in the considerations that the court must take into account, it is convenient to quote it now:

"(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others,
(d) the impact of the company's operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company."

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Derivative claims

73. I should begin by saying a little about derivative claims generally. In the first place the new code has replaced the common law derivative action. A derivative claim may "only" be brought under the Act. As s.260(1) makes clear a derivative claim is one in which the cause of action is vested in the company, but where the claim is brought by a member of the company. This reflects the old law in which a derivative action was an exception to the general principle (known as the rule in *Foss v Harbottle* (1843) 2 Hare 461) that where an injury is done to a company only the company may bring proceedings to redress the wrong. Allied to this principle was the principle that whether a company should bring proceedings to redress a wrong was a matter that was to be decided by the company internally; that is to say by its board of directors, or by a majority of its shareholders if dissatisfied by the board's decision. The court would not second guess a decision made by the company in accordance with its own constitution. The exception to these principles was necessitated where the company's own constitution could not be properly operated. If the wrongdoers were in control of the company (because they were a majority of the shareholders) they would not in practice vote in favour of taking proceedings against themselves, even though the taking of proceedings would be in the company's best interests. As Lord Denning M.R. put it in *Wallersteiner v Moir (No.2)* [1975] Q.B. 373, 390:

> "It is a fundamental principle of our law that a company is a legal person, with its own corporate identity, separate and distinct from the directors or shareholders, and with its own property rights and interests to which alone it is entitled. If it is defrauded by a wrongdoer, the company itself is the one person to sue for the damage. Such is the rule in *Foss v. Harbottle* (1843) 2 Hare 461. The rule is easy enough to apply when the company is defrauded by outsiders. The company itself is the only person who can sue. Likewise, when it is defrauded by insiders of a minor kind, once again the company is the only person who can sue. But suppose it is defrauded by insiders who control its affairs – by directors who hold a majority of the shares – who then can sue for damages? Those directors are themselves the wrongdoers. If a board meeting is held, they will not authorise the proceedings to be taken by the company against themselves. If a general meeting is called, they will vote down any suggestion that the company should sue them themselves. Yet the company is the one person who is damnified. It is the one person who should sue. In one way or another some means must be found for the company to sue. Otherwise the law would fail in its purpose. Injustice would be done without redress."

74. Lord Denning was clearly contemplating a case in which the company's cause of action was a cause of action against the "insiders" themselves who would be liable for damages. Indeed that seems to be the usual situation in which derivative actions were allowed to continue. That is why this exception to the rule in *Foss v Harbottle* (above) was often called a "fraud on the minority".

75. A derivative claim, as defined by s.260(3) is not, however, confined to a claim against the insiders. As the concluding part of that sub-section says, the cause of action may be against the director or another person (or both). Nevertheless the cause of action must *arise from* an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust *by a director* of the company. A derivative claim may "only" be brought under Pt 11 Ch.1 in respect of a cause of action having this characteristic (although this restriction does not appear to apply to a derivative claim brought in pursuance of an order made under s.994). Thus the section contemplates that a cause of action may arise from, say, the default of a director, but nevertheless is a cause of action against a third party. A claim against a person who had dishonestly assisted in a breach of fiduciary duty or

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who had knowingly received trust property would be paradigm examples. It is also to be noted that it is not a requirement that the delinquent director should have profited or benefited from his misconduct. He may be guilty of no more than negligence in managing the company's affairs. However, since the cause of action must arise from his default (etc.) a derivative claim brought under Pt 11 Ch.1 will not allow a shareholder to pursue the company's claim against a third party where that claim depends on a cause of action that has arisen independently from the director's default (etc.). This view would be consistent with what the Law Commission said in their report *Shareholders' Remedies* which paved the way for this part of the Companies Act 2006. They said:

> "6.31 So far as the second situation is concerned, one respondent gave the following example. A profitable company is a victim of a tort by a third party, and the board, although otherwise committed to the well-being of the company, have ulterior motives of their own for not wishing to enforce the remedy for the tort. Although the board would in those circumstances be in breach of duty, their breach would not have given rise to the claim.
>
> 6.32 We accept that in this type of situation an individual shareholder would have no right to bring a derivative action against the third party tortfeasor under our proposals. (There would of course be a potential claim for damages against the directors themselves, although this may give rise to difficulties of causation or quantification, and it is possible that the directors may not have sufficient funds to meet the claim). However, we do not consider that this is an issue which needs to be addressed for two main reasons.
>
> 6.33 First, we are not aware of any cases under the current law where a derivative action has been successfully brought in circumstances such as those described in paragraph 6.31.
>
> 6.34 Secondly, (and more importantly) it is consistent with the proper plaintiff principle which we endorsed in the consultation paper and which received virtually unanimous support on consultation. The decision on whether to sue a third party (ie someone who is not a director and where the claim is not closely connected with a breach of duty by a director) is clearly one for the board. If the directors breach their duty in deciding not to pursue the claim then (subject to the leave of the court) a derivative claim can be brought against them. To allow shareholders to have involvement in whether claims should be brought against third parties in our view goes too far in encouraging excessive shareholder interference with management decisions. This is particularly important as we are proposing that derivative actions are to be available in respect of breaches of directors' duties of skill and care. A line has to be drawn somewhere and we consider that this is both a logical and clearly identifiable place in which to draw the line."

76. Under the old law there was a procedural problem: if the fraud was not admitted by the insiders, how was it to be proved? As the Court of Appeal observed in *Prudential Assurance Co Ltd v Newman Industries Ltd (No.2)* [1982] Ch. 204, 221:

> "It cannot have been right to have subjected the company to a 30-day action (as it was then estimated to be) in order to enable him to decide whether the plaintiffs were entitled in law to subject the company to a 30-day action. Such an approach defeats the whole purpose of the rule in *Foss v. Harbottle* and sanctions the very mischief that the rule is designed to prevent. By the time a derivative action is concluded, the rule in *Foss v. Harbottle* can have little, if any, role to play. Either the wrong is proved, thereby establishing conclusively the rights of the company; or the wrong is not proved, so *cadit quaestio*."

77. The procedural solution that the Court of Appeal devised was to require that:

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> "In our view, whatever may be the properly defined boundaries of the exception to the rule, the plaintiff ought at least to be required before proceeding with his action to establish a *prima facie* case (i) that the company is entitled to the relief claimed, and (ii) that the action falls within the proper boundaries of the exception to the rule in *Foss v. Harbottle*."

78. The Act now provides for a two-stage procedure where it is the member himself who brings the proceedings. At the first stage, the applicant is required to make a prima facie case for permission to continue a derivative claim, and the court considers the question on the basis of the evidence filed by the applicant only, without requiring evidence from the defendant or the company. The court must dismiss the application if the applicant cannot establish a prima facie case. The prima facie case to which s.261(1) refers is a prima facie case "for giving permission". This necessarily entails a decision that there is a prima facie case both that the company has a good cause of action and that the cause of action arises out of a directors' default, breach of duty (etc.). This is precisely the decision that the Court of Appeal required in *Prudential* (above). As mentioned, Norris J. considered the application on paper, and considered that there was a prima facie case. Hence the hearing before me.

79. However, in order for a claim to qualify under Pt 11 Ch.1 as a derivative claim at all (whether the cause of action is against a director, a third party or both) the court must, as it seems to me, be in a position to find that the cause of action relied on in the claim arises from an act or omission involving default or breach of duty (etc.) by a director. I do not consider that at the second stage this is simply a matter of establishing a prima facie case (at least in the case of an application under s.260) as was the case under the old law, because that forms the first stage of the procedure. At the second stage something more must be needed. In *Fanmailuk.com Ltd v Cooper* [2008] EWHC 2198 (Ch); [2008] B.C.C. 877 Mr Robert Englehart QC said that on an application under s.261 it would be "quite wrong … to embark on anything like a mini-trial of the action". No doubt that is correct; but on the other hand not only is something more than a prima facie case required, but the court will have to form a view on the strength of the claim in order properly to consider the requirements of s.263(2)(a) and 263(3)(b). Of course any view can only be provisional where the action has yet to be tried; but the court must, I think, do the best it can on the material before it.

80. One innovation of the new code is the ability of a shareholder to apply to the court under s.262 for permission to take over a claim that the company has already brought. The Law Commission explained the thinking behind this as follows:

> "6.63 … We do not want individual shareholders to apply to take over current litigation being pursued by their company just because they are not happy with the progress being made. The provision is intended to deal with those situations where the company's real intention in commencing proceedings is to *prevent* a successful claim being brought."

81. In parallel with a derivative action, there was (and is) the possibility of bringing a petition for unfair prejudice. This procedure is now governed by s.994 of the Companies Act 2006. The relief which the court may give under s.996 is very wide-ranging ("such order as it thinks fit"); but the section specifically provides that the court may require the company to do an act that the petitioner has complained that it has omitted to do; or authorise civil proceedings to be brought in the name and on behalf of the company by such person or persons and on such terms as it may direct. If a petition is brought the court will decide (on the balance of probabilities) in the course of the petition whether the affairs of the company have been conducted in a manner unfairly prejudicial to the petitioner. It is only if the court has decided that they have that it will go on to consider the appropriate relief. It will be noted that s.260(1) contains a general definition of "derivative claim" and s.260(2) envisages

two different ways in which such a claim may be brought. One is "under this Chapter", in which case the restriction on the permissible cause of action contained in s.260(3) applies ("A derivative claim *under this Chapter* may only be brought …"). The other is pursuant to an order made in proceedings under s.994, in which case the restrictions in s.260(3) do not apply. In that case, the general definition in s.260(1) is the only relevant definition of a derivative claim.

82. Accordingly it seems to me that where the petitioner's complaint is that the company has failed to assert a good claim against a third party the court's powers under s.996 would include the making of an order requiring the company to assert that claim, if necessary by taking or defending proceedings. Since the company's claim would be a claim against a third party, once the court had decided that a failure to assert that claim had unfairly prejudiced the petitioner, the directors would not need to be parties to the subsequent claim against the third party. In addition the width of the court's jurisdiction under s.996 enables the joinder of third parties to the petition itself, at least where relief is claimed against them: *Re Little Olympian Each-Ways Ltd* [1994] B.C.C. 959; *Lowe v Fahey* [1996] B.C.C. 320.

83. On the other hand, it may be that the company's cause of action is a cause of action only against the directors for loss suffered as a result of their default or breach of duty (etc.). In such a case the directors will be necessary parties to the company's claim. It may be, therefore, that different procedural routes will be adopted depending on the company's underlying claim.

Is there a mandatory bar on the claim?

84. Mr de Verneuil Smith, appearing for Mr Barnes and Ms Walker and their companies Rimbal and Horrocks, submitted that this was a case in which I was required to refuse permission because s.263(2)(a) applied. This says that the court must refuse permission if the court is "satisfied" that:

> "a person acting in accordance with section 172 (duty to promote the success of the company) would not seek to continue the claim."

85. As many judges have pointed out (e.g. Warren J. in *Airey v Cordell* [2007] EWHC 2728 (Ch); [2007] B.C.C. 785, 800 and Mr William Trower QC in *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch); [2008] B.C.C. 885, 893–894) there are many cases in which some directors, acting in accordance with s.172, would think it worthwhile to continue a claim at least for the time being, while others, also acting in accordance with s.172, would reach the opposite conclusion. There are, of course, a number of factors that a director, acting in accordance with s.172, would consider in reaching his decision. They include: the size of the claim; the strength of the claim; the cost of the proceedings; the company's ability to fund the proceedings; the ability of the potential defendants to satisfy a judgment; the impact on the company if it lost the claim and had to pay not only its own costs but the defendant's as well; any disruption to the company's activities while the claim is pursued; whether the prosecution of the claim would damage the company in other ways (e.g. by losing the services of a valuable employee or alienating a key supplier or customer) and so on. The weighing of all these considerations is essentially a commercial decision, which the court is ill-equipped to take, except in a clear case.

86. In my judgment therefore (in agreement with Warren J. and Mr Trower QC) s.263(2)(a) will apply only where the court is satisfied that *no* director acting in accordance with s.172 would seek to continue the claim. If some directors would, and others would not, seek to continue the claim the case is one for the application of s.263(3)(b). Many of the same considerations would apply to that paragraph too.

87. Mr de Vernueil Smith also emphasised that the claim under consideration is the claim against the directors themselves for default or breach of duty (etc.). What the hypothetical director had to consider was not whether (for example) Mr Barnes was entitled to terminate the SSA but whether the board had been in breach of duty (etc.) in accepting that he could, having had the benefit of legal advice both in England and Australia. Likewise, in relation to the trust claim the question was not whether the trust claim was a good one; but whether the board were in breach of duty (etc.) in proposing to compromise Rimbal's action on the basis of the legal advice they had received from counsel and solicitors in Australia.

88. Even if I were not satisfied that no director, acting in accordance with s.172, would seek to continue the claim, the importance that such a director would attach to continuing the claim is a relevant discretionary consideration. I will therefore consider the merits of the claims first.

Rescission of the SSAs

89. Mr Wardell QC accepted that, rightly or wrongly, the rescission had taken place and that history could not be undone or rewritten. The company's claim, therefore, was limited to a financial claim against the board for breach of duty in accepting Mr Barnes' entitlement to rescind.

90. Although it was at one time disputed, Mr Iesini now accepts the Westrip did not issue compliant preference shares in time. Since the SSA provided expressly that time was of the essence of the contract, late allotment and issue of compliant preference shares would not have cured the problem. (Indeed although Mr Boyle and Walford considered that it was too late to issue the shares after the *redemption* date had passed, it seems to me that it was already too late to issue them once the *settlement* date had passed). Accordingly, as a matter of strict legal right, Mr Barnes and Ms Walker were entitled to rescind (or terminate) the SSAs when they did. But whether this conclusion is right or wrong, the fact remains that the board took advice from eminent and specialist counsel on what is a very technical matter of company law. They followed that advice. It is, in my judgment, impossible to say that they were negligent or in breach of duty in doing so. Moreover, if the old board (who included Mr Iesini and his brother) had done what the SSA required Westrip to do, and had done so before they were ousted in the boardroom coup in June 2008, there would have been no question of rescission. Mr Wardell's answer was that they relied on professionals (solicitors and company secretary) to do the necessary and could not be criticised for that. But if they could not be criticised for following the advice of apparently incompetent professionals, how can the new board be criticised for following the advice of apparently competent professionals?

91. It follows that any defence that Westrip might have had must be based either on waiver or estoppel. None of the lawyers consulted by the board, either in England or Australia, expressly considered whether there might be a defence based on waiver or estoppel. However, that is not the fault of the board. Mallesons were asked on October 8, 2008, immediately following the rescission notice, whether there was "some other action or defence that Westrip needs to take". The question posed was entirely open. Mallesons' reply considered, albeit briefly, both obligations of good faith and unconscionable conduct, and said that the facts favoured Mr Barnes and Ms Walker. I do not see how the board can realistically be criticised for that.

92. It is also worthy of note that the particulars of claim, served in June 2009, did not allege an estoppel or waiver. Rather it alleged that the rescission and its acceptance was a sham (an allegation that has now been withdrawn) based on an assertion that compliant redeemable preference shares had in fact been issued (an allegation that has been abandoned) and that the board did not believe that they had not (an allegation for which there is no evidence at all). The allegation of an estoppel did

not surface until Mr Iesini's fifth witness statement dated September 16, 2009. The plea of estoppel is now contained in the draft amended particulars of claim. If it has taken this long for Mr Iesini to raise the allegations of waiver and estoppel, I do not see that it is realistic to criticise the board for not having raised them in the much shorter timescale in which they were operating.

93. During the course of these proceedings Mr Iesini has received advice from Lipman Karas, who are Australian lawyers. The advice was given on September 16, 2009. It was not, therefore, before the board when they came to their decision to accept the rescission. Lipman Karas' advice is that the right to rescind contained in cl.18(a)(iii) of the SSA is likely to be interpreted by an Australian court as amounting to a right to terminate the agreement, rather than a right to rescind it ab initio. The consequence of this, they suggest, is that termination would not affect rights and obligations arising from partial performance or causes of action accruing from breach. They say that:

> "Barnes and Walker may therefore be prevented by a Court from exercising the rights to terminate [under the SSA] if Westrip is able to establish that Barnes and Walker had affirmed the Agreements, that they should be estopped from terminating the Agreements, or that they were in breach of implied terms requiring them to act in good faith."

94. So far as affirmation is concerned, they say it is not possible to assess whether the agreements have been affirmed. They do not however, address the impact of cl.21 of the SSA (any waiver must be in writing).

95. So far as estoppel is concerned they say:

> "On the material available to us we consider that the conduct of the parties demonstrates that each of them shared an agreed assumption that the redeemable preference shares had been validly issued and allotted to Barnes and Walker and that their relationship, prior to October 2008, was conducted on the basis of that shared assumption. Circumstances such as the entry of the redeemable preference shares in the names of Barnes and Walker into Westrip's share register and entry into the Second Variation Agreement support the existence of this assumption."

96. In my judgment this reasoning does not withstand analysis. To take the second variation agreement first, its purpose was to extend the settlement date under the SSA. The settlement date was the date on which the redeemable preference shares were to be allotted and issued. But if the parties were acting on the shared assumption that the shares "had been" validly issued and allotted, what was the point of extending the settlement date? I cannot see the answer to that question. The postponement of the settlement date is, as it seems to me, wholly inconsistent with any assumption or understanding that compliant redeemable preference shares had *already* been allotted and issued. So far as the entry on the share register is concerned, this had not happened when the electronic copy of the share register was taken in May 2008. It happened at some time between then and September 25, as is now common ground, although the entry was back-dated. There is no evidence that Mr Barnes or Ms Walker knew that the entry had been made; and no evidence that they did anything that could support the estoppel after the date upon which the entry was actually made.

97. Insofar as the claim relies on the payment of £300,000 made in June 2007 as contributing to the estoppel, the claim has two major problems. First, the payment was made pursuant to the second variation agreement, which postponed the settlement date. As I have said, the postponement of the settlement date is inconsistent with a shared assumption that compliant preference shares had already been issued. Accordingly, Mallesons' advice to the effect that the payment of £300,000 was not paid under the original SSA was, in my judgment, correct. Even if it was not correct it was, to put it no higher, a reasonable view to take. Secondly, the payment was not characterised as a partial redemption

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until the events of January 4, 2008. On that date the board passed an ordinary resolution to redeem the shares, and the board purported to do so out of the company's capital. But s.173 of the Companies Act 1985 (which was in force at the time) says that a payment out of capital by a private company for the redemption of shares "is not lawful" unless the requirements of ss.173–175 are satisfied. One of the requirements of s.173 was that the payment must be approved by a special resolution of the company. There was no such resolution: there was only an ordinary resolution of the board. There is, in my judgment, a heavy burden placed upon a party who seeks to support an estoppel by relying on a transaction that Parliament has said is not merely invalid but "unlawful". It is true that in *Shah v Shah* [2001] EWCA Civ 527; [2002] Q.B. 35 the Court of Appeal took a more flexible view of the effect of statutory requirements on alleged estoppels by convention than had been taken by the same court in *Godden v Merthyr Tydfil Housing Association* (1997) 74 P. & C.R. D1. However, even in *Shah v Shah* the court recognised that the public policy reasons underlying a statutory requirement may preclude its being overridden by estoppel. In the present case the statutory prohibition must be aimed at protecting the members of a company and its creditors. In my judgment these considerations of public policy mean that the statutory prohibition cannot be overridden by an estoppel by convention alleged to arise between the company and only one or two of its members.

98. Looked at in the cold light of day, after several rounds of written evidence, skeleton arguments, the reading of seven lever arch files of exhibits and some four days of legal argument, there is a little more mileage in the estoppel argument based on the approval of Westrip's financial statement for the year ending January 31, 2007, which was collectively approved by the shareholders after the expiry of the last of the extended settlement dates. But even that would have to surmount the difficulty caused by Mr Barnes' letter of June 23, 2008, in which he said that if payment was not made Rimbal would "revert back to the original owners". The remedy for non-payment on the redemption date (if the redeemable preference shares had in fact been issued) was not reversion of shares in Rimbal, but the winding up of Westrip. In the course of a winding up, Mr Barnes and Ms Walker would have been entitled to prove for their debt, but the shares in Rimbal would have been sold, together with all Westrip's other assets. The shares in Rimbal would only revert to their original owners if the redeemable preference shares had not been issued by the settlement date. So Mr Barnes' letter of June 23 is inconsistent with the alleged common assumption.

99. At the time of the decision to accept the rescission, the board did not of course have the benefit of the detailed arguments deployed before me. They were also conscious of the fact that Westrip had no money. So even if the estoppel argument had been run, Westrip could not have redeemed the shares; and in the financial climate then prevailing (just at the start of the credit crunch) the board cannot be said to be in breach of duty in thinking that finance would be hard to raise. Failure to redeem the shares would have caused Westrip to be wound up.

100. There is a subsidiary part of the claimants' argument on rescission which I found hard to understand. It is said that an Australian court would construe the right to rescind as a right to terminate the SSA prospectively, thus discharging the parties from future performance, rather than a right to rescind ab initio. Thus far, I am willing to agree. It follows, so the argument runs, that rights which have accrued before the termination are unaffected by the termination. I am willing to agree with that too. On that footing, it is argued that the shares in Rimbal, which had already been transferred to Westrip by Mr Barnes and Ms Walker before the termination did not have to be re-assigned to them once the SSA was terminated. I simply do not understand how that can be. In the first place Westrip did not have a right to the shares under the SSA until the settlement date, and then only in exchange for the purchase consideration. The premature delivery of the share certificates was not something to which Westrip was entitled. It gave no consideration for that premature transfer. So it is not deprived

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of any accrued rights by having to re-transfer them on termination. Secondly, if the argument is right, Westrip would be entitled to keep the shares without paying for them. I cannot see any court allowing that outcome.

101. It follows in my judgment that no criticism can be legitimately levelled at the board for re-transferring the shares in Rimbal to Mr Barnes and Ms Walker following the termination of the SSA.

102. In my judgment this is a clear case. The strength of the claim against the board is so weak that I conclude that no director, acting in accordance with s.172, would seek to continue the claim against the directors in respect of their actions in accepting the rescission of the SSA. If I am wrong about that, the case is so weak that a person acting in accordance with s.172 would attach little weight to continuing it.

Restitution

103. The restitutionary claim is pleaded in the draft amended particulars of claim as follows:

> "105. Further or in the alternative, in the belief that it owned the licences Westrip incurred expenditure in developing the Tanbreez licence as set out above. If, contrary to Westrip's case, its belief that it owned the Licences was wrong because the share purchase agreements were liable to be and have been validly rescinded, it incurred that expenditure acting under a mistake. Rimbal and Horrocks would be unjustly enriched at the expense of Westrip by the re-transfer of the shares as they would benefit from the enhanced value of the Tanbreez licence.
> 106. The claimants, on behalf of Westrip, therefore seek an order for restitution of the value of the benefit conferred on Rimbal and Horrock. The claimants cannot particularise the value of the benefit at this stage: it will be a matter for expert evidence."

104. The striking point about this plea is that it contains no allegation of default or breach of duty (etc.) on the part of any director of Westrip. The cause of action does not arise out of the default or breach of duty (etc.) of a director. As pleaded, therefore, it is not a derivative claim which can be brought under Ch.1. It must be brought, if at all, pursuant to an order of the court made in proceedings under s.994.

The trust claim

105. The trust claim differs from the rescission claim in a number of respects:

(i) if the trust exists, it exists independently of any default or breach of duty (etc.) by the board. If it exists it does so because Westrip paid for the pegging of the licence and (more importantly) because Rimbal has acknowledged and warranted the existence of the trust in a number of deeds to which Westrip was a party and upon which it plainly relied in entering into JV arrangements;

(ii) if there is a trust it still exists, and Westrip's primary concern must be to establish beneficial ownership of its own assets. Unlike the rescission claim therefore, this is more than a financial claim against the directors;

(iii) if the trust exists, then as it seems to me, Westrip will have provided good consideration under the terms of the joint venture with Broadstone and subsequently with GGG. If that is right, then Westrip will be entitled to retain both its share in the joint venture and also its shares in GGG;

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(iv) since the trust claim exists independently of any default or breach of duty (etc.) by the directors, it is not a cause of action which arises out of any such default or breach of duty (etc.). The underlying trust claim does not, therefore, fall within the definition of a derivative claim capable of being brought under Ch.1 (although it could be brought following proceedings under s.994);

(v) Mr Todd's clients (Mr Schønwandt, Mr Powar and Westrip) have now accepted that there is at least an arguable claim that the trust exists, and have said that the board will reconsider their decision to enter into the proposed consent order forming the second stage of the proposed settlement. If, having reconsidered the position, the board decides to assert the existence of the trust there is no real point in pursuing a claim against them because their previous decision will not have resulted in any loss to Westrip.

106. The board defend their decision principally on the ground that they took legal advice from senior and junior counsel in Australia and also from Mallesons and followed that advice. There is force in that defence, although it is to some extent undermined by the fact that the board apparently allowed the instructions to counsel to be given by Mr Barnes and Ms Walker who had an obvious conflict of interest.

107. My personal view (for what it is worth, and I appreciate that it is the board's view that counts) is that the trust claim is a strong one based both on the underlying facts, and also (to my mind more importantly) on the acknowledgements by Rimbal of the existence of the trust in the side deed and the subsequent deeds of novation coupled with the obvious reliance by Westrip and GGG on those acknowledgements. I do not consider that these documents were given any real weight by Australian counsel. I find that surprising. There are, however, factors other than the strength of the claim that the board will have to consider in making a decision whether or not to assert the trust. As I have said those factors are ones that the court is ill-equipped to weigh.

108. In those circumstances I consider that the best course of action is for me to exercise the power under s.261(4)(c) of the Act and to direct the board to reconsider Westrip's defence to the action brought by Rimbal.

109. If they decide to maintain a defence to the claim, then there will be no need for a derivative action. If on the other hand, they decide to sign the tri-partite consent order, Westrip's claim to beneficial ownership of both licence 2005/17 and the GGG shares will have been irretrievably lost. In that event, there may well be something of real value to argue about. Either way, the board will have to explain its decision and the reasoning process that led to it.

110. I might add that GGG is of course entitled to defend the claim brought against it on the basis that the trust exists and that its joint venture partner remains Westrip.

Conspiracy

111. In the end I think that Mr Wardell accepted that the conspiracy claim added little if anything to the other claims. I think that this is right. So far as the Weyhill offer is concerned, that went nowhere. If, as I have concluded, the directors were justified in accepting the effectiveness of the rescission of the SSAs, their action in doing so was not unlawful. Since the consent order in the Australian proceedings has not been signed off, no loss has been caused to Westrip.

Miscellaneous matters

112. A number of other points were argued. In the light of my substantive decision they may not arise; but I should deal with them briefly.

Are the claimants proper claimants?

113. Both Mr Todd and Mr de Verneuil Smith argued strenuously that the claimants (and in particular Messrs Iesini) were not proper claimants. This was in part based on an allegation that they were not acting in good faith in seeking to continue the claim (which is one of the factors that the court must consider pursuant to s.263(3)(a) of the Act).

114. Mr Iesini revealed in his third witness statement that he and his co-claimants had the benefit of an indemnity from GGG; but he refused to disclose its terms. At the beginning of the hearing I ruled that it had to be disclosed; and it was. An examination of the terms of the indemnity show that in return for the indemnity as to both costs and damages, the claimants have promised GGG to use their best endeavours to procure that Westrip enter into an agreement to terminate the existing joint venture. Among those terms is the transfer of the Southern Licence to a subsidiary of GGG. The indemnity also provides for GGG's consent to be obtained before the claimants take any material step in the action or settle the claim.

115. Mr Todd relied on the decision of the Court of Appeal in *Nurcombe v Nurcombe* (1984) 1 B.C.C. 99,269, 99,273; [1985] 1 W.L.R. 370, 376 in which Lawton L.J. said:

> "It is pertinent to remember, however, that a minority shareholder's action in form is nothing more than a procedural device for enabling the court to do justice to a company controlled by miscreant directors or shareholders. Since the procedural device has evolved so that justice can be done for the benefit of the company, whoever comes forward to start the proceedings must be doing so for the benefit of the company and not for some other purpose. It follows that the court has to satisfy itself that the person coming forward is a proper person to do so. In *Gower, Modern Company Law*, 4th ed (1979), the law is stated, in my opinion correctly, in these terms, at p. 652:
>
>> 'The right to bring a derivative action is afforded the individual member as a matter of grace. Hence the conduct of a shareholder may be regarded by a court of equity as disqualifying him from appearing as plaintiff on the company's behalf. This will be the case, for example, if he participated in the wrong of which he complains.'"

116. This approach was followed by Lawrence Collins J. in *Konamaneni v Rolls Royce Industrial Power (India) Ltd* [2003] B.C.C. 790; [2002] 1 W.L.R. 1269. Likewise in *Barrett v Duckett* [1995] B.C.C. 362 Peter Gibson L.J. said:

> "The shareholder will be allowed to sue on behalf of the company if he is bringing the action bona fide for the benefit of the company for wrongs to the company for which no other remedy is available. Conversely if the action is brought for an ulterior purpose or if another adequate remedy is available, the court will not allow the derivative action to proceed."

117. In that case one of the reasons which led the court to refuse to allow a derivative action to proceed was that it was being pursued as part of a family feud, rather than for the financial benefit of the claimant.

118. In *Central Estates (Belgravia) Ltd v Woolgar* [1972] 1 Q.B. 48 a lessee made a claim to acquire the freehold of his house under the Leasehold Reform Act 1967. The making of such a claim prevented the landlord from forfeiting the lease unless the lessee had not made his claim in good faith. Lord Denning M.R. said:

> "To my mind, under this statute a claim is made in good faith" when it is made honestly and with no ulterior motive. It must be made by the tenant honestly in the belief that he has a lawful right to acquire the freehold or an extended lease, and it must be made without any ulterior motive, such as to avoid the just consequences of his own misdeeds or failures."

119. The idea that an action which is being pursued for a collateral purpose is abusive is not a new one in our law. Such an action is liable to be struck out as an abuse of process. In *Goldsmith v Sperrings Ltd* [1977] 1 W.L.R. 478 Bridge L.J. (with whom Scarman L.J. agreed) considered the meaning of a "collateral advantage" in this context. He said:

> "The phrase manifestly cannot embrace every advantage sought or obtained by a litigant which it is beyond the court's power to grant him. Actions are settled quite properly every day on terms which a court could not itself impose upon an unwilling defendant. An apology in libel, an agreement to adhere to a contract of which the court could not order specific performance, an agreement after obstruction of an existing right of way to grant an alternative right of way over the defendant's land – these are a few obvious examples of such proper settlements. In my judgment, one can certainly go so far as to say that when a litigant sues to redress a grievance no object which he may seek to obtain can be condemned as a collateral advantage if it is reasonably related to the provision of some form of redress for that grievance. On the other hand, if it can be shown that a litigant is pursuing an ulterior purpose unrelated to the subject matter of the litigation and that, but for his ulterior purpose, he would not have commenced proceedings at all, that is an abuse of process. These two cases are plain; but there is, I think, a difficult area in between. What if a litigant with a genuine cause of action, which he would wish to pursue in any event, can be shown also to have an ulterior purpose in view as a desired by-product of the litigation? Can he on that ground be debarred from proceeding? I very much doubt it."

120. Mr Todd and Mr de Verneuil Smith say that it is clear from the terms of the indemnity that the action is not being brought for Westrip's benefit at all. It is really being brought for the benefit of GGG which wants to get out of the joint venture agreement (a deal that it now regrets) on the best possible terms. Mr Iesini's response is that the derivative claim, if allowed to proceed is plainly for Westrip's benefit, since if the claim succeeds it will recover substantial compensation for the loss of its interest in Rimbal and will confirm ownership of Licence 2005/17 (now the Northern and Southern Licences) and its shares in GGG. Moreover even when the indemnity is taken into account there are clear benefits to Westrip under the terms envisaged for the termination of the joint venture, since those terms make it more likely that Westrip will receive substantial amounts of cash.

121. In my judgment if the claimant brings a derivative claim for the benefit of the company, he will not be disqualified from doing so if there are other benefits which he will derive from the claim. In *Nurcombe* Lawton L.J. contrasted an action for the benefit of the company on the one hand, and an action brought for some other purpose on the other. Likewise in *Barrett* Peter Gibson L.J. drew the same contrast. Neither of them was considering a case in which a claim was brought partly for the benefit of the company, but partly for other reasons as well. In my judgment in such a case the considerations discussed by Bridge L.J. in *Goldsmith* come into play. In the present case it seems to me that Mr Iesini was entitled to form the view that unless the derivative claim was brought, Westrip

would be left with no assets at all. Thus in my judgment the dominant purpose of the action was to benefit Westrip. It cannot, in my judgment, be said that but for the collateral purpose, the claim would not have been brought at all. The claim is, in my judgment, brought in good faith.

122. However, in relation to the rescission claim there is a different objection. As the passage from *Nurcombe* shows a person may be prevented from bringing a derivative claim if he participated in the wrong of which he complains; and as the passage from *Central Belgravia* shows it will count against a claimant if the action is brought to escape the consequences of his own misdeeds. In the present case if the old board (which included both Messrs Iesini) had done what the SSA required to be done and spelled out in great detail, there would have been no question of a rescission. On one view, therefore, the real cause of Westrip's loss was not the new board's failure to investigate a possible defence based on estoppel, but the old board's failure to follow the steps set out in meticulous detail in the SSA (and in the checklist prepared for Westrip) which led to the new board finding itself in the predicament that it did. Had I formed the view that the rescission claim should be allowed to proceed I would not have considered that Messrs Iesini were proper claimants.

Alternative remedy

123. I have already quoted the passage from *Barrett* in which Peter Gibson L.J. seems to suggest that the availability of another remedy is an absolute bar to a derivative action. In *Konameneni* Lawrence Collins J. said (799; 1279) that the notion that there must be no alternative remedy is not an independent bar to a derivative action, but was simply an example of a case where there will be no relevant wrongdoer control. Whatever the correct position under the old law might have been, in my judgment under the new code the availability of an alternative remedy is not an absolute bar. If it were then it would have been a mandatory ground for refusing permission under s.263(2) rather than a discretionary consideration under s.263(3)(f).

124. The relevant alternative remedy in the present case is an unfair prejudice petition under s.994. From the point of view of the company itself a petition under s.994 is far preferable, principally because it will only be a nominal party and will not incur legal costs; whereas in the ordinary way if a derivative action is brought for its benefit it will be liable to indemnify the claimant against his costs, even if the claim is unsuccessful: *Wallersteiner v Moir (No.2)*. At this point I should mention briefly the decision of Walton J. in *Smith v Croft* (1986) 2 B.C.C. 99,010; [1986] 1 W.L.R. 580. Mr Todd relied on it for the proposition that a claimant must demonstrate a genuine need for an indemnity before the court will order one. However, that is not what Walton J said. In *Smith v Croft* Walton J. was concerned with two appeals from the master. The first appeal was from an order made ex parte ordering the company to indemnify the claimant against costs. The appeal against that order was allowed, and Walton J. decided that there was so little substance in the claim that no indemnity was appropriate. The second appeal was against an order permitting the claimants to tax their bills at intervals, without waiting for the outcome of the action. It was in the context of the second appeal only (i.e. whether there should be an *interim* payment on account of costs) that Walton J. said:

> "Early payment — i.e. before the conclusion of the trial — does indeed impose an additional liability. That may become necessary: if, for example, the plaintiff is a person who literally has no resources of his own, then it may well be that an order for interim payment should be made in order to ensure that the action proceeds at all. Without the supplementary order, the original order may stand in danger of being stultified.
>
> It therefore appears to me that in order to hold the balance as fairly as may be in the circumstances between plaintiffs and defendants, it will be incumbent on the plaintiffs applying for such an

order to show that it is genuinely needed — i.e. that they do not have sufficient resources to finance the action in the meantime. If they have, I see no reason at all why this extra burden should be placed upon the company."

125. Thus in my judgment Mr Michael Wheeler QC was right in *Jaybird Group Ltd v Greenwood* [1986] B.C.L.C. 319, 327 to say that an indemnity as to costs in a derivative claim is not limited to impecunious claimants. The justification for the indemnity is that the claimant brings his claim for the benefit of the company (and ex hypothesi under the new law the court has allowed it to proceed). Once the court has reached the conclusion that the claim ought to proceed for the benefit of the company, it ought normally to order the company to indemnify the claimant against his costs.

126. The potential liability of the company for costs is, in my judgment, a proper consideration for the court in deciding whether to allow a derivative claim to proceed. In the present case the combination of that potential liability and the availability of an alternative remedy under s.994 would have led me to the conclusion that, on the facts as they now are, if I had not adjourned the application so far as it related to the trust claim, it would not have been appropriate to allow the derivative claim to proceed.

Views of members with no personal interest

127. In *Smith v Croft (No.3)* (1987) 3 B.C.C. 218 Knox J. said (at 255):

"Ultimately the question which has to be answered in order to determine whether the rule in *Foss v. Harbottle* applies to prevent a minority shareholder seeking relief as plaintiff for the benefit of the company is, 'Is the plaintiff being improperly prevented from bringing these proceedings on behalf of the company?' If it is an expression of the corporate will of the company by an appropriate independent organ that is preventing the plaintiff from prosecuting the action he is not improperly but properly prevented and so the answer to the question is, 'No'. The appropriate independent organ will vary according to the constitution of the company concerned and the identity of the defendants who will in most cases be disqualified from participating by voting in expressing the corporate will.
Finally on this aspect of the matter I remain unconvinced that a just result is achieved by a single minority shareholder having the right to involve a company in an action for recovery of compensation for the company if all the other minority shareholders are for disinterested reasons satisfied that the proceedings will be productive of more harm than good. If Mr. Potts' argument is well founded once control by the defendants is established the views of the rest of the minority as to the advisability of the prosecution of the suit are necessarily irrelevant. I find that hard to square with the concept of a form of pleading originally introduced on the ground of necessity alone in order to prevent a wrong going without redress."

128. It seems probable that this was the inspiration behind s.263(4) which provides that:

"In considering whether to give permission (or leave) the court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter."

129. Nevertheless this sub-section is not easy to understand. All the members of a company have an obvious interest in any claim brought on the company's behalf. The value of their shareholdings may be increased or diminished depending on the outcome. Unless "personal interest" is being used in contra-distinction to "financial interest" it is difficult to see who would not have an interest. Another possible reading is that "the matter" is not the question whether or not to give permission, but is the

alleged default (etc.) of the directors out of which the cause of action has arisen. It may be that what the section is trying to get at is that the court must have regard to the views of members of the company who are not implicated in the alleged wrongdoing, and who do not stand to benefit otherwise than in their capacity as members of the company. If that reading is correct (as I think it probably is) it raises another question: how is the court to resolve any dispute about whether a member or the company is or is not involved in the alleged wrongdoing or stands to benefit otherwise than his capacity as a member of the company?

130. Mr Todd relied on the evidence of Mr Kasserer and Mr Bosme as being independent shareholders who did not support the derivative claim. Mr Iesini challenged their assertions that they had no personal interest, direct or indirect in the matter. It does appear that they have an understanding with Mr Barnes that they will receive substantial interests in Rimbal, although both of them say that nothing has been written down and nothing is legally binding. But that in itself may give them a reason to support Mr Barnes and Rimbal in the hope that gratitude for their support will spur him to honour the informal understanding. Moreover, in so far as concerns the factual basis for the trust claim Mr Iesini has demonstrated, to my mind, cogent reasons for concluding that their initial evidence was unreliable. It seems to me that in order for the court to be in a position to have "particular" regard to the views of certain members of the company it must be as satisfied as it can be on an interim application that they are not financially interested in the outcome (beyond their interest as shareholders in the company). In the present case I am not so satisfied. I do not, therefore, pay particular regard to the evidence of Messrs Kasserer and Bosme as I am not satisfied that they fall within the description of the class of member to whose evidence s.263(4) requires me to have particular regard.

The injunction

131. As mentioned, on July 27, 2009, Proudman J. granted an injunction which prevented dealings in, among other things, the Tanbreez licence and Westrip's shareholding in GGG. The only possible justification for the inclusion of Tanbreez within the scope of the order was the allegation that the rescission of the SSA was a sham. Now that that allegation has been abandoned, and that Mr Iesini accepts that the rescission was effective, it is plain that Westrip can have no further claim over the Tanbreez licence. Equally, it seems to me that since Mr Iesini asserts (and always has asserted) that Westrip is legally and beneficially entitled to the GGG shares, there can be no ground on which the freezing order can be maintained in respect of those shares. If, as he says, the shares belong to Westrip, it can do as it likes with them. Moreover the shares are very volatile, and if Westrip is prevented from dealing with them it may miss valuable market opportunities. Mr Wardell said that Mr Iesini was fearful that the proceeds of sale of the shares might be passed to Rimbal. However, in circumstances in which the board has said that it will reconsider Westrip's position in Rimbal's Australian proceedings, it does not seem to me that there is cogent evidence that that is a real risk at present.

132. Mr de Verneuil Smith submitted that the injunction should be discharged in its entirety on the ground that the basis on which it was granted was a claim that has now been abandoned. The main planks of the case as presented to Proudman J. were that the redeemable preference shares had been validly issued and that the rescission was a sham. Neither allegation is now maintained. There is some force in this submission, at least as regards the Tanbreez licence, but since I have decided that the freezing order should be lifted in relation to that, the force of the submission is limited. The allegation that the Northern and Southern Licences are held on trust by Rimbal for Westrip remains and that claim is, as it seems to me, stronger now than it was before Proudman J. In those circumstances

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I consider that the injunction should remain in force in relation to those licences pending the adjournment of this application.

133. That raises the question of the cross-undertaking in damages. Mr Iesini says, that by analogy with the position of a liquidator (see *Re DPR Futures Ltd* (1989) 5 B.C.C. 603; [1989] 1 W.L.R. 778) any cross-undertaking should be limited to the value of Westrip's assets. I do not agree. In my view:

(i) The position of a liquidator is different because he has no personal interest in the outcome of the action. In the present case the claimants have a lively interest in the outcome of the action.
(ii) In *DPR* itself, assets worth £2.3 million were frozen and the offered cross-undertaking was valued at £2 million. In the present case, if the cross-undertaking is ever called upon the assets of Westrip are unlikely to be able to cover the loss.
(iii) In the present case, as Mr Iesini has said, the claimants have the benefit of an indemnity from GGG, which extends to any damages awarded against the claimants; and he relied on that in his third witness statement when dealing with the value of the cross-undertaking.
(iv) If a cross-undertaking is inadequate that may, in itself, be a reason for refusing an injunction.
(v) Had Mr Iesini pursued his alternative remedy under s.994 he would not have been entitled to limit an undertaking in that way.

134. Accordingly, while I am prepared to continue the injunction as regards the Northern and Southern licences, I will only do so on the basis of a personal cross-undertaking by Mr Iesini and his co-claimants.

Result

135. I refuse permission to continue the claim in so far as it relates to the allegations of conspiracy, the decision not to contest the rescission and the restitutionary claim. (Technically, it may be that I am, or am also, refusing permission to amend the particulars of claim, but I do not think that the technicalities matter.) I will adjourn the application insofar as it relates to the trust claim, in order to allow the board to reconsider their position. Pending the board's decision, I will continue the injunction so far as it relates to the Northern and Southern Licences, provided that the claimants give an unlimited cross-undertaking in damages.

(Order accordingly)

Chapter 3 Directors in the Corporate Governance Process

[3.1]

While this book focuses on directors' duties, this topic cannot be addressed adequately without considering the position of directors in relation to the corporate governance process, because directors' duties are regarded as a critical corporate governance mechanism[1]. The way that directors act and make decisions is central to corporate governance. The board of directors is responsible for the governance of their companies[2]. It is appropriate that a consideration of corporate governance issues relating to directors and how they fulfil their duties is included in this work. However, it must be emphasised that this chapter does not purport to engage in a substantial consideration of the whole topic of corporate governance, which is voluminous. It merely seeks to set out the context and act as a form of introduction to what follows in relation to duties of directors. First, the chapter explains the meaning of 'corporate governance'. Then the chapter proceeds to discuss the problem that exists in large companies, namely the separation of ownership and control. This is followed by an examination of the issue that has been debated for many years: to whom are duties of directors owed? In this regard the focus is on the two primary theories that have addressed this issue, namely the shareholder value theory and the stakeholder theory. Next, the chapter provides a brief discussion of the agency theory as this theory is often used as the basis for arguing for the existence of duties. The chapter ends with a discussion of the need, as part of the corporate governance process, for directors to ensure that they record actions and decisions.

[1] I M Ramsay 'The Corporate Governance Debate and the Role of Directors' Duties' in I M Ramsay (ed) *Corporate Governance and the Duties of Company Directors* (Centre for Corporate Law and Securities Regulation, University of Melbourne, 1997) at 10.

[2] *Report on the Financial Aspects of Corporate Governance* (London, Gee, 1992) at para 2.5 ('Cadbury Report').

I DEFINING CORPORATE GOVERNANCE

[3.2]

While concerns over corporate governance have been with us since the emergence of the joint stock company many years ago[1], it is over the past 30 years or so that the topic of corporate governance has become a critical aspect of company law, and it has spawned a huge amount of literature. Notwithstanding all of this, it is not an easy expression to define. It has been variously defined. Some commentators emphasise that it is about the understanding of, and institutional arrangements for, relationships among the many actors who may have direct or indirect interests in the company[2]. Some commentators argue for a narrow definition while others put forward broader definitions[3]. There are a myriad of explanations of corporate governance. Here are some of them.

[1] D Prentice 'Some Aspects of the Corporate Governance Debate' in D Prentice and P Holland (eds) *Contemporary Issues in Corporate Governance* (Oxford, Clarendon Press, 1993) at 26.

[2] S Letza, X Sun and J Kirkbride 'Shareholding and Stakeholding: A Critical Review of Corporate Governance' (2004) 12 *Corporate Governance: An International Review* 242 at 242.

[3] For more detailed discussion, see A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge, 2013) at 15–19.

[3.3]

It has been said that corporate governance is 'concerned with the relationship between the structure of rules, laws and conventional practices within which companies operate and their style of management and the decisions that they make'[1].

[1] C Villiers and G Boyle 'Corporate Governance and the Approach to Regulation' in L Macgregor, T Prosser and C Villiers (eds) *Regulation and Markets Beyond 2000* (Dartmouth, Ashgate, 2000) at 221 and referring to J Kay and K Silberston 'Corporate Governance' (1995) 153 *National Institute Economic Review* at 85.

[3.4]

Professor John Farrar has said that corporate governance is a subject that involves considerations of 'the legitimacy of corporate power, corporate accountability and standards by which the corporation is to be governed and by whom'[1]. Professors Simon Deakin and Alan Hughes have defined corporate governance at a fundamental level as being 'concerned with the relationship between the internal governance mechanisms of corporations, and society's conception of the scope of corporate accountability'[2].

[1] J Farrar 'Corporate Governance, Business Judgment and the Professionalism of Directors' (1993) 5 *Corporate and Business Law Journal* 1.

[2] 'Comparative Corporate Governance: An Interdisciplinary Agenda' (1997) 24 *Journal of Law and Society* 1 at 2.

[3.5]

Perhaps the broadest (and briefest) explanation is the statement of Thomas Clarke in his introduction to the excellent inter-disciplinary book on corporate governance, *Theories of Corporate Governance*: 'It concerns the exercise of power in corporate entities.[1]'

[1] New York, Routledge, 2004 at 1.

[3.6]

Of importance for this book is the definition contained in the *Report on the Financial Aspects of Corporate Governance* (commonly referred to as 'the Cadbury Report'), namely, 'the system by which companies are directed and controlled'[1]. This is a definition that has been frequently cited all around the world. A predecessor of the Department for Business Energy and Industrial Strategy, the Department for Business Enterprise and Regulatory Reform, took the Cadbury definition and added to it. It stated[2]:

> "Corporate governance is the system by which companies are directed and controlled. It deals largely with the relationship between the constituent parts of a company – the directors, the board (and its sub-committees) and the shareholders."

[1] London, Gee, 1992 at para 2.5.

[2] The definition originally appeared at www.berr.gov.uk/bbf/corp-governance/page15267.html and now this has been superseded by the following address: http://webarchive.nationalarchives.gov.uk/20090902193559/berr.gov.uk/whatwedo/businesslaw/corp-governance/page15267.html.

[3.7]

There is much to be said for the view that corporate governance is concerned with: who controls the company, for whom is the company governed and the ways in which control is exerted[1].

[1] H Gospel and A Pendleton 'Finance, Corporate Governance and the Management of Labour: A Conceptual and Comparative Analysis' (2003) 41 *British Journal of Industrial Relations* 557 at 560.

[3.8]

According to the financial economists, agency theorists and law and economics scholars, corporate governance is a matter of how shareholders address directorial opportunism and shirking.

[3.9]

Certainly, corporate governance is of concern because of the potential (if not actual) conflict of interest that exists for those persons who are involved in the company. For instance, the directors who effectively control the company, the managers, have a conflict of interest, namely between benefitting themselves through their position or benefitting the company (and ultimately the shareholders). Dealing with the conflicts concerned cannot be left entirely to contract, because, inter alia, it is difficult, if not impossible, to draft contracts that cover all possible eventualities. The result is that all contracts are incomplete (due to cognitive limitations)[1].

[1] See A Keay and H Zhang 'Incomplete Contracts, Contingent Fiduciaries and a Director's Duty to Creditors' (2008) 32 *Melbourne University Law Review* 141.

[3.10]

The duties owed by directors are clearly seen as an integral part of the corporate governance system, and operate to address, to a degree, the conflicts that directors have in their role[1]. But, one of the major debates that has haunted company law for many years is: to whom do directors owe their duties in the governance process? This is an issue that is considered in CHAPTER 4 and CHAPTER 6, but we need to deal with it in the context of corporate governance at this point as it is a critical aspect of company law and really involves issues that go well beyond the topic of duties. We will consider the matter once we have examined some critical theories that are relevant to dealing with the issue of: to whom are duties owed?[2]

[1] There are, of course, other mechanisms that are employed, such as contracts and members' powers to vote and remove directors.

[2] For a discussion of this issue, see A Keay *The Corporate Objective* (Cheltenham, Edward Elgar, 2011).

Directors' Duties/Chapter 3 Directors in the Corporate Governance Process/II Separation of ownership and control and directorial discipline

II SEPARATION OF OWNERSHIP AND CONTROL AND DIRECTORIAL DISCIPLINE

[3.11]

There are two principal organs of the company: the members in general meeting and the board of directors[1]. During the nineteenth century the board was seen as the delegate of the general meeting and the meeting

could direct the board[2]. But since the decisions in *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cunninghame*[3] and *Quin & Arxtens Ltd v Salmon*[4], where the powers of the board are given by provisions in the articles the members have not been able to interfere in the actions taken by the directors, and the members cannot direct how the board operates. Barwick CJ of the Australian High Court said in *Ashburton Oil NL v Alpha Minerals NL*[5] that:

> "Directors who are minded to do something which in their honest view is for the benefit of the company are not to be restrained because a majority shareholder or shareholders holding a majority of shares in the company do not want the directors so to act.[6]"

1 See *John Shaw & Sons (Salford) Ltd v Shaw* *[1935] 2 KB 113 at 134*.

2 For instance, see *Isle of Wight Rly Co v Tahourdin* (1883) and noted in A Dignam and J Lowry *Company Law* (OUP, 5th edn, 2008) at 264.

3 *[1906] 2 Ch 34*.

4 *[1909] AC 442*. This is the position also in Australia. For instance, see *Howard Smith Ltd v Ampol Petroleum Ltd* *[1974] AC 821 at 837* (a Privy Council decision on appeal from Australian courts); *NRMA Ltd v Parker (1986) 6 NSWLR 517*, *(1986) 11 ACLR 1*, *(1986) 4 ACLC 609*.

5 *(1971) 123 CLR 614*.

6 (1971) 123 CLR 614 at 620.

[3.12]

There is little said in the CA 2006 concerning the division of power between members and directors. Typically, today the company's articles of association will vest in the board of directors' broad general management powers[1] concerning the affairs of the company, and this will determine the power distribution in a company. Where directors have been given wide-ranging powers, then they alone can exercise them, and the only thing that the members can do is to pass a special resolution to amend the articles[2]. The directors must report to the members in general meeting, but a major issue in corporate governance is whether the directors are sufficiently accountable to the members[3]. Undoubtedly, 'the requirement of accountability in financial and managerial decision-making is a mainstay of the regulatory system of modern corporate law'[4]. If there was not accountability then directors could well engage in furthering self-interests (referred to usually as 'self-dealing' or 'opportunism') or failing to do all that they could for shareholders (referred to as 'shirking') and members could become mistrustful of the directors. But the fact of the matter is that without accountability then no matter whether directors acted properly or not, the element of suspicion would exist[5]. Accountability of boards is required to balance the fact that boards are given such broad power and authority[6].

1 The Companies (Model Articles) Regulations 2008, SI 2008/3229, reg 2, Sch 1, art 5 (private companies); reg 4, Sch 3, art 5 (public companies); the Companies (Tables A–F) Regulations 1985, art 70 of Table A.

2 *John Shaw & Sons (Salford) Ltd v Shaw* *[1935] 2 KB 113*.

3 R P Austin, H A J Ford and I M Ramsay *Company Directors* (Sydney, LexisNexis Butterworths, 2005) at 62. See A Keay *Board Accountability in Corporate Governance* (Abingdon, Routledge, 2015).

4 S Bottomley *The Constitutional Corporation* (Aldershot, Ashgate, 2007) at 58.

5 S Bottomley *The Constitutional Corporation* (Aldershot, Ashgate, 2007) at 73. For a discussion of the importance of accountability in corporate governance, see M Moore *Corporate Governance in the Shadow of the State* (Hart Publishing, 2013); A Keay *Board Accountability in Corporate Governance* (Abingdon, Routledge, 2015).

6 A Keay *Board Accountability in Corporate Governance* (Abingdon, Routledge, 2015).

[3.13]

In the larger Anglo-American company shareholding has tended to be dispersed. It is a critical element of corporate governance is that as the shareholding is so dispersed no one shareholder or group of shareholders have effective control over the management of the company. Besides running and overseeing the running of the company, the board of directors has the ability to control the processes of meetings of shareholders, being able to rely on proxy voting and the conduct of meetings to enhance their control. The movement of power from those who 'own' the company, namely the shareholders[1], to those who control it, the directors and managers, and with it the idea of separation of control and ownership, was first identified by American academics, Adolf Berle and Gardiner Means in the early 1930s[2], and it has generally been accepted today as explaining the situation that exists in larger companies in Anglo-American jurisdictions[3]. However, it must be said that there is not so much of a dispersed ownership in listed UK companies now compared with previous years[4]. A large portion of UK shares in listed companies are owned either by institutional shareholders or foreign shareholders. Yet the size of interests held by leading shareholders in companies still remain relatively small, and no shareholder will hold a majority.

1 The shareholders do not, in legal terms, own the company, although economists often refer to the company's shareholders as owning the company. See M Lipton and S Rosenblum 'A New System of Corporate Governance: The Quinquennial Election of Directors' (1991) 58 U Chi L Rev 187 at 195; P Ireland 'Capitalism Without the Capitalist: The Joint Stock Company Share and the Emergence of the Modern Doctrine of Separate Corporate Personality' (1996) 17 *Legal History* 40; M Eisenberg 'The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm' (1999) 24 J Corp L 819; S Worthington 'Shares and Shareholders: Property, Power and Entitlement' (Part 1) (2001) 22 Co Law 258 and Part 2 (2001) 22 Co Law 307. Also, see *Short v Treasury Commissioners* [1948] 1 KB 116 at 122 where Evershed LJ denied the fact that shareholders were the owners of a company; Committee on the Financial Aspects of Corporate Governance (Cadbury Report) (London, Gee, 1992) at para 6.1; Confederation of British Industries, *Boards Without Tiers: A CBI Contribution to the Debate* (London, CBI, 1996) at 8.

2 See A A Berle and G Means *The Modern Corporation and Private Property* (New York, MacMillan, 1932).

3 In small companies the shareholders and the directors are often one and the same, so there is no real separation between ownership and control.

4 See the latest available report from the Office for National Statistics on *Ownership of UK Quoted Shares 2018* and accessible at: https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2018.

[3.14]

The vast majority of companies in the UK are small private companies, often with few shareholders. Corporate governance issues, while often different to those applying to large public companies, are also relevant to these companies. The difference is that the companies will not have dispersed ownership, for the most part, but concentrated ownership, often with one person holding the majority of the shares. In many companies the shareholders are also the directors so ownership and control is in the hands of the same people. But in some companies only some shareholders will be directors and this can lead to corporate governance problems, the most concerning of which is that the directors end up running the company for their benefit and not for the benefit of the company as a whole.

[3.15]

As directors are in control of a company, and key to the whole corporate governance process, it is necessary to ensure that they are subject to some disciplinary measures if they fail to perform or act improperly. It has been asserted that the concept of separation of ownership and control 'leads inexorably to the conclusion that the central goal of corporate governance is to discipline managers …'[1]. Professors Julian Franks, Colin Mayer and Luc Renneboog identify[2] five ways in which managers can be disciplined for poor performance. These are:

- replacement following the acquisition of a large block of shares;
- bidders may take action after acquiring a company;
- non-executive directors might replace directors;
- financial crises might lead to interventions by shareholders when new equity is issued; and
- shareholders might intervene and remove directors or request the board to replace directors[3].

1 M Lipton and S Rosenblum 'A New System of Corporate Governance: The Quinquennial Election of Directors' (1991) 58 U Chi L Rev 187 at 187.

2 'Who Disciplines Management in Poorly Performing Companies?' (2001) 10 *Journal of Financial Intermediation* 209 at 210.

3 Perhaps we can add liquidation and administration to the list. These insolvency regimes will see the control of the company being taken from the directors and given to an independent office-holder who will investigate the actions of the directors. Generally, see A Keay 'Company Directors Behaving Poorly: Disciplinary Options for Shareholders' [2007] JBL 656.

[3.16]

The effectiveness of these avenues for discipline vary. The mechanism that has attracted a lot of support over the years, particularly as far as large companies is concerned, is the takeover. The theory provides that if directors are not performing, then they risk the company being taken over by another company that sees the potential of the former company, and subsequently, after completion of the takeover, the directors in post before that will be dismissed. But there has been theoretical argument[1] and some empirical research[2] that denies the efficacious nature of the takeover in this regard. The general use of the market for corporate control has also been questioned as an adequate device for disciplining directors[3]. Much is often made of the fact that the shareholders have ultimate power in a company, because they can vote to remove directors or refrain from re-electing them, but it has been argued that there are significant hurdles put in front of shareholders if they wish to take disciplinary action against directors[4].

1 M Lipton and S Rosenblum 'A New System of Corporate Governance: The Quinquennial Election of Directors' (1991) 58 U Chi L Rev 187 at 188; R Booth 'Stockholders, Stakeholders and Bagholders (or How Investor Diversification Affects Fiduciary Duty)' (1998) 53 *The Business Lawyer* 429 at 440. For a more recent view, see L Bebchuk 'The Myth of the Shareholder Franchise' (2007) 93 *Virginia Law Review* 675.

2 J Franks and C Mayer 'Hostile Takeovers in the UK and the Correction of Managerial Failure' (1996) 40 *Journal of Financial Economics* 163.

3 See I Anabtawi 'Some Skepticism About Increasing Shareholder Power' (2006) 53 UCLA L Rev 561 at 568.

4 A Keay 'Company Directors Behaving Poorly: Disciplinary Options for Shareholders' [2007] JBL 656.

[3.17]

One of the major concerns, in relation to companies of all shapes and size, is to ensure that directors do not engage in opportunistic and self-serving activity or shirking (failing to do their jobs properly). Various strategies can be put in place to prevent this. One of those is the imposition of duties on directors. Duties imposed on directors are attempts to lay down standards of behaviour, whatever the circumstances.

[3.18]

As mentioned above, the largest proportion of companies that are incorporated in the UK are small companies. In such companies ownership and control are often not separated. If individual directors do shirk or act opportunistically in such companies then they might be subject to action from the board. Where all directors shirk or act opportunistically it might precipitate the presentation of a petition under CA 2006, s 994 where the petitioner claims that the company's affairs are being conducted in a manner that is unfairly prejudicial to the interests of the members, or the bringing of a derivative action against the directors for breach of duty[1].

[1] See CHAPTER 14.

Directors' Duties/Chapter 3 Directors in the Corporate Governance Process/III To whom are duties owed?/A Shareholder value principle

III TO WHOM ARE DUTIES OWED?

[3.19]

As indicated earlier in the chapter, this has been a hotly debated question for many years, and continues to be so. It is not possible to do justice to the question in this book[1], given the focus on duties, but we do need to discuss it to some extent. In this section of the chapter the major arguments, and some of the primary counter-arguments, are set out.

[1] For a detailed discussion, see A Keay *The Corporate Objective* (Cheltenham, Edward Elgar, 2011).

[3.20]

Notwithstanding which of the major views is adopted concerning the correct subjects of duties, all are agreed that the duties of directors are a significant aspect of company law. As indicated earlier, this book, while touching on policy and some theoretical issues at times, is focused on providing an examination of the law and seeking to undertake an analysis of it.

[3.21]

There are two primary views as to whom directors owe duties[1], known as the shareholder value theory[2] (also known as 'shareholder primacy' and 'shareholder wealth maximisation'[3]), and stakeholder theory.

[1] Another recently devised approach, based on entity theory, is the entity maximisation and sustainability model. See A Keay 'Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model' (2008) 71 MLR 663; A Keay *The Corporate Objective* (Cheltenham, Edward Elgar, 2011).

[2] For a discussion of the theory, see, for example, D Gordon Smith 'The Shareholder Primacy Norm' (1998) 23 *Journal of Corporate Law* 277; L Stout 'Bad and Not-so-Bad Arguments for Shareholder Primacy' (2002) 75 *Southern California Law Review* 1189; A Keay 'Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?' (2010) 7 *European Company and Financial Law Review* 369.

[3] S Bainbridge 'In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green' (1993) 50 *Washington and Lee Law Review* 1423; M Roe 'The Shareholder Wealth Maximization Norm and Industrial Organization' (2001) U Pa L Rev 2063; S Bainbridge 'Director Primacy: The Means and Ends of Corporate Governance' (2003) 97 *Northwestern University*

Law Review 547 at 549, 552, 565. The UK's Company Law Review Steering Group did in fact refer to the principle simply as 'shareholder value' (Company Law Review, *Modern Company Law for a Competitive Economy*: 'The Strategic Framework' (London, DTI, 1999) at paras 5.1.12ff).

A Shareholder value principle
1 From a theoretical viewpoint

[3.22]

The shareholder value theory has been largely fostered as a leading principle of corporate law by the contractarian school of thought in the United States[1]. It was in the US in the early 1930s that we find the genesis of the debate concerning the objective of a company. It all really started in earnest with the debates between Professors Adolf Berle of Columbia University and E Merrick Dodd of Harvard University, and carried out in the literature published at the time[2]. Berle maintained, inter alia, that while there was merit in directors, as managers of companies, having responsibilities to stakeholders in general he could not see that approach being able to be enforced so he accepted a form of shareholder primacy for companies[3]. On the other hand, Dodd resolutely held that the public saw companies as economic institutions that have a social service role to play as well as making profits for shareholders, and that companies had responsibilities to the company's shareholders, employees, customers, and to the general public[4]. While the former conceded defeat eventually, the last three decades of the twentieth century and the first couple of decades of this century has arguably been characterised as a time when many of Berle's views held sway, especially in the US. It has been said that there has been an ever-increasing focus on shareholder value and certainly since the early-1980s[5]. As we will see, Dodd's approach has effectively been championed by the second theory we will consider.

[1] This is not to say that those who do not see themselves as contractarians do not agree with shareholder primacy. For some of the leading works on the principle, see J Macey 'An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties' (1991) 21 *Stetson Law Review* 23; S Bainbridge 'In Defense of the Shareholder Maximization Norm: A Reply to Professor Green' (1993) 50 *Washington and Lee Law Review* 1423; B Black and R Kraakman 'A Self-Enforcing Model of Corporate Law' (1996) 109 *Harvard Law Review* 1911; D Gordon Smith 'The Shareholder Primacy Norm' (1998) 23 J Corp L Rev 277. It must be noted that some contractarians do not accept shareholder primacy: D D Prentice 'The Contractual Theory of the Company and the Protection of Non-Shareholder Interests' in D Feldman and F Meisel (eds) *Corporate and Commercial Law: Modern Developments* (London, Lloyds of London Press, 1996) at 121.

[2] See A A Berle 'Corporate Powers as Powers in Trust' (1931) 44 Harv L R 1049; E M Dodd 'For Whom are Corporate Managers Trustees?' (1932) 45 Harv L R 1145; A A Berle 'For Whom Managers are Trustees: A Note' (1932) 45 Harv L R 1365. Also, see A A Berle and G Means *The Modern Corporation and Private Property* (New York, MacMillan, 1932); E M Dodd 'Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?' (1935) 2 U Chi L R 194.

[3] A A Berle 'Corporate Powers as Powers in Trust' (1931) 44 Harv L R 1049 at 1049. The view was put forward, in effect, in the earlier decision of *Dodge v Ford Motor Co (1919) 170 NW 668* (Michigan).

[4] E M Dodd 'For Whom are Corporate Managers Trustees?' (1932) 45 Harv L R 1145 at 1148.

[5] M Omran, P Atrill and J Pointon 'Shareholders Versus Stakeholders: Corporate Mission Statements and Investor Returns' (2002) 11 *Business Ethics: A European Review* 318 at 319.

[3.23]

In a nutshell the shareholder value approach is that the directors are to aim to run the company for the ultimate benefit of the shareholders, that is all decisions should be directed to providing benefits for shareholders, and so directors' duties are owed to the shareholders.

[3.24]

The contractarian theorists, many of whom advocate a law and economics approach to law, focus on the contractual relationships that exist between persons involved in the affairs of the company, and, accordingly, hold to the principle of the sanctity of contract. Many contractarians[1] regard the company as nothing more than a number of complex, private consensual contract-based relations[2], either express or implied, and they consist of many different kinds of relations that are worked out by those voluntarily associating in a company[3]. The parties involved in these contracts are regarded as rational economic actors, and includes shareholders, managers, creditors and employees, and it is accepted that each of these constituencies endeavour in their contracting to maximise their own positions, with the intention of producing concomitant benefits for themselves[4]. This scheme is usually known by the shorthand expression of 'a nexus of contracts'[5]. The nexus of contracts theory in relation to the firm was devised by economists[6] and embraced by economically inclined law academics[7]. The contractarians generally[8] regard shareholder value as the focal point of their view of the public company[9]. The principle fills gaps in the corporate contract[10]; it establishes 'the substance of the corporate fiduciary duty'[11].

[1] For example, Eugene Fama 'Agency Problems and the Theory of the Firm' (1990) 99 *Journal of Political Economics* 288 at 290.

[2] Referring to the relations as contracts is probably incorrect from a legal perspective. Some authors refer to the relations as bargains as some of the relations do not constitute contracts in a technical sense. See M Klausner 'Corporations, Corporate Law and Networks of Contracts' (1995) 81 *Virginia Law Review* 757, 759.

[3] F Easterbrook and D Fischel 'The Corporate Contract' (1989) 89 Colum L Rev 1416 at 1426. At 1428 the learned commentators give examples of some of the arrangements.

[4] See H Butler 'The Contractual Theory of the Corporation' (1989) 11 *George Mason University Law Review* 99; C A Riley 'Understanding and Regulating the Corporation' (1995) 58 MLR 595 at 598.

[5] The literature considering the nexus of contracts is too voluminous to cite. But see, for example, E E Fama 'Agency Problems and the Theory of the Firm' (1980) 88 *Journal of Political Economy* 228, 290; F Easterbrook and D Fischel 'The Corporate Contract' (1989) 89 Colum L Rev 1416, 1426–1427. The nexus of contracts approach is critiqued by William W Bratton Jr in 'The “Nexus of Contracts Corporation”: A Critical Appraisal' (1989) 74 Cornell L Rev 407 at 412, 446–465.

[6] See R Coase 'The Nature of the Firm' (1937) 4 *Economica* 386 at 390–392; A Alchian and H Demsetz 'Production, Information Costs, and Economic Organization' (1972) 62 Am Econ Rev 777 at 794; M Jensen and W Meckling 'Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305.

[7] See F Easterbrook and D Fischel 'The Corporate Contract' (1989) 89 Colum L Rev 1416; Easterbrook and Fischel *The Economic Structure of Company Law* (Cambridge, Mass, Harvard University Press, 1991) at 37–39; W Bratton Jr 'The “Nexus of Contracts” Corporation: A Critical Appraisal' (1989) 74 Cornell L Rev 407.

[8] Not all contractarians might agree with this.

[9] M Bradley, C Schipani, A Sundaram and J Walsh 'The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads' (1999) 62 *Law and Contemporary Problems* 9 at 38.

[10] F Easterbrook and D Fischel *The Economic Structure of Company Law* (Cambridge, Mass, Harvard University Press, 1991) at 90–93; J Macey and G Miller 'Corporate Stakeholders: A Contractual Perspective' (1993) 43 *University of Toronto Law Review* 401 at 404.

[11] T Smith 'The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty' (1999) 98 *Michigan Law Review* 214 at 217. A view with which Professor Smith disagrees (ibid).

[3.25]

The preference for shareholder value is not a consequence of a 'philosophical predilection'[1]; towards shareholders, but a concern that the business should be run for the benefit of the residual claimants, namely, the

shareholders, while the company is solvent[2]. That is, putting it simply, the shareholders get the residue of the company's earnings, after paying off all obligations. This is probably regarded as the primary argument in favour of the shareholder value approach. The residual claimants have the greatest stake in the outcome of the company[3], as they will benefit if the company's fortunes increase, but they will lose out if the company hits hard times (with their claims being last in line if the company is liquidated), and they will value the right to control above any other stakeholders[4], as they have an interest in every decision that is taken by a solvent firm[5]. It has been said by some that as shareholders are the owners of the company[6], those who manage the company should do so for the benefit of the shareholders[7]. In law the shareholders are not the owners. All they own is a share in the company which is a separate legal entity that holds property for itself.

[1] M Bradley, C Schipani, A Sundaram and J Walsh 'The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads' (1999) 62 *Law and Contemporary Problems* 9 at 37.

[2] F Easterbrook and D Fischel *The Economic Structure of Company Law* (Cambridge, Mass, Harvard University Press, 1991) at 36–39.

[3] J Macey 'Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective' (1999) 84 *Cornell Law Review* 1266 at 1267. This has been queried by several commentators, such as Professor Margaret Blair (*Ownership and Control* (Washington DC, The Brookings Institute, 1995) at 229).

[4] M Van der Weide 'Against Fiduciary Duties to Corporate Stakeholders' (1996) 21 *Delaware Journal of Corporate Law* 27 at 57; M Bradley, C Schipani, A Sundaram and J Walsh 'The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads' (1999) 62 *Law and Contemporary Problems* 9 at 38.

[5] J Macey and G Miller 'Corporate Stakeholders: A Contractual Perspective' (1993) 43 *University of Toronto Law Review* 401 at 408.

[6] For example, see Committee on the Financial Aspects of Corporate Governance (Cadbury Report) (London, Gee, 1992) at para 6.1; Confederation of British Industries *Boards Without Tiers: A CBI Contribution to the Debate* (London, CBI, 1996) at 8.

[7] This view has been criticised by many. See E Sternberg 'The Defects of Stakeholder Theory' (1997) 5 *Corporate Governance: An International Review* 3.

[3.26]

There are other arguments[1] that are propounded in favour of shareholder value[2]. First, according to the prevailing agency theory[3], which is discussed a little later in the chapter, directors are the agents of the shareholders and are employed to run the company's business for the shareholders who do not have the time or ability to do so, and it is the shareholders who are best suited to guide and discipline directors in the carrying out of their powers and duties[4]. It is said that if we do not have shareholder value as the guiding principle, the directors are able to engage in opportunistic behaviour and to shirk. Costs, known as 'agency costs'[5], will be incurred in monitoring the work of the directors, and so as to reduce the incidence of shirking and engaging in opportunistic activity the existence of duties owed to shareholders reduces those costs and, at the same time, protects the shareholders. The upshot is that shareholder value means that directors are fully accountable for what they do in running the company's business.

[1] For a detailed discussion, see, for example, D Gordon Smith 'The Shareholder Primacy Norm' (1998) 23 *Journal of Corporate Law* 277; L Stout 'Bad and Not-so-Bad Arguments for Shareholder Primacy' (2002) 75 *Southern California Law Review* 1189; A Keay 'Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?' (2010) 7 *European Company and Financial Law Review* 369.

[2] Parts of the following arguments are taken from A Keay 'Enlightened Shareholder Value, the Reform of the Duties of Company Directors and the Corporate Objective' [2006] LMCLQ 335 at 339–340; A Keay 'Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model' (2008) 71 MLR 663 at 668–669.

[3] This is based on a large number of works, but arguably the most influential are: M Jensen and W Meckling 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305; E Fama 'Agency Problems and the Theory of the Firm' (1980) 88 J Pol Econ 288; E Fama and M Jensen 'Separation of Ownership and Control' (1983) 26 *Journal of Law and Economics* 301; F Easterbrook and D Fischel *The Economic Structure of the Corporate Law* (Cambridge, MA, Harvard University Press, 1991).

[4] J Matheson and B Olson 'Corporate Law and the Long-term Shareholder Model of Corporate Governance' (1992) 76 *Minnesota Law Review* 1313 at 1328.

[5] These costs are those resulting from managers failing to act appropriately and the costs expended in monitoring and disciplining the managers in order to prevent them abusing their positions.

[3.27]

Secondly, it is argued that the principle is based on efficiency (the great concern of economists and those favouring a law and economics approach to legal analysis). Shareholders have incentives to maximise profits and so they are likely to foster economic efficiency. It is more efficient if directors operate on the basis of maximising shareholder wealth, because the least cost is expended in doing this[1]; the directors can work more efficiently if they are focused only on one objective, rather than worrying about a range of objectives.

[1] M van der Weide 'Against Fiduciary Duties to Corporate Stakeholders' (1996) 21 *Delaware Journal of Corporate Law* 27 at 56–57.

[3.28]

Thirdly, and allied to the previous argument, if directors owe duties to various constituencies, then it would be impossible for directors to balance all of the divergent interests, with the result that directors will make poor decisions[1]. It is said that the principle is certain and easy to administer, especially when compared with the stakeholder theory[2], under which directors are to act with all stakeholder interests in view. With shareholder value there is just one main aim and that is to foster the interests of the shareholders. Shareholder value allows, so the argument goes, courts to review managerial conduct with some rationality[3], because directors are to focus on only one goal.

[1] The Committee on Corporate Law 'Other Constituency Statutes: Potential for Confusion' (1990) 45 *The Business Lawyer* 2253 at 2269. It is generally felt that life would be made somewhat easier for directors if shareholder value did not exist as they could more easily justify decisions that they make.

[2] M van der Weide 'Against Fiduciary Duties to Corporate Stakeholders' (1996) 21 *Delaware Journal of Corporate Law* 27 at 68.

[3] M van der Weide 'Against Fiduciary Duties to Corporate Stakeholders' (1996) 21 *Delaware Journal of Corporate Law* 27 at 69.

[3.29]

Fourthly, it is argued that constituencies other than the shareholders are able to protect themselves by the terms of the contracts that they make (eg a creditor lends money subject to a loan agreement), while shareholders do not have this kind of protection. The assertion is made that the shareholders are vulnerable[1] in that they are not, unlike say creditors, able to negotiate special terms by way of contract, and they are, in many ways, at the mercy of the directors, for they have difficulty in monitoring the work of directors. Fifthly, unlike some groups, such as creditors, shareholders are not always able to diversify their exposure to losses sustained by their investments[2]. Finally, shareholders are not, except in listed companies, always able to exit easily a company with which they are not happy, and, therefore, they warrant some special treatment.

1 See L Zingales 'Corporate Governance' in *The New Palgrave Dictionary of Economics and Law* (Basingstoke, MacMillan, 1997) at 501.

2 Many may argue that shareholders often diversify their investments and therefore reduce their exposure.

[3.30]

It has been asserted in recent times that corporate governance debates have now been resolved in favour of the shareholder value model[1]. Professor Ronald Gilson has even said that corporate law's only distinctive feature is as a means to increase shareholder value[2]. But, while this theory is hugely popular, it has not been without significant opposition. Many who oppose it have adopted a progressive (formerly known as communitarian) or pluralist approach to corporate law[3] and have argued that directors should be required to consider the interests of others besides shareholders, namely those whom we can call stakeholders. It is said that directors should be obliged to run companies for the benefit of all potential stakeholders or constituencies in companies, such as creditors, employees, suppliers, customers and the communities in which the company operates. It is asserted by many that the interests of shareholders are not the only interests to be considered by directors when carrying out their functions, for there are other important constituencies that warrant consideration from directors[4]. The effect of invoking a shareholder value approach is, arguably, to damage the incentives of non-shareholder stakeholders to make firm-specific investments in companies as they are aware that their investments will be subordinated to shareholder interests at all times[5], and Professor Lyman Johnson has said that 'a radically proshareholder vision of corporate endeavour [is] substantially out of line with prevailing social norms'[6], and that courts must acknowledge this and define 'the meaning of corporate endeavour'[7]; by embracing norms 'wider than the thin thread of shareholder primacy'[8].

1 H Hansmann and R Kraakman 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439.

2 'Separation and the Function of Corporation Law' (January 2005) Stanford Law and Economics Olin Working Paper No 307 and available at: http://ssrn.com/abstract=732832.

3 For discussions of this approach to corporate law, see, for example, L Mitchell (ed) *Progressive Corporate Law* (Westview Press, 1995); W Bratton Jr 'The "Nexus of Contracts Corporation": A Critical Appraisal' (1989) 74 Cornell L Rev 407; L Mitchell 'The Fairness Rights of Bondholders' (1990) 65 *New York University Law Review* 1165; D Millon 'Theories of the Corporation' [1990] Duke LJ 201; L Johnson 'The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law' (1990) 68 *Texas Law Review* 865. Also, see W Leung 'The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime that Recognizes Non-Shareholder Interests' (1997) 30 *Columbia Journal of Law and Social Problems* 589; G Crespi 'Rethinking Corporate Fiduciary Duties: The Inefficiency of the Shareholder Primacy Norm' (2002) 55 SMU Law Rev 141; L Talbot *Progressive Corporate Governance for the 21st Century* (Abingdon, Routledge, 2014).

4 For example, Professor Lawrence Mitchell criticises the whole notion of shareholder maximisation in corporate law ('A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes' (1992) 70 *Texas Law Review* 579 at 640).

5 G Kelly and J Parkinson 'The Conceptual Foundations of the Company: A Pluralist Approach' in J Parkinson, A Gamble and G Kelly (eds) *The Political Economy of the Company* (Oxford, Hart Publishing, 2000) at 131.

6 'The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law' (1990) 68 *Texas Law Review* 865 at 934.

7 'The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law' (1990) 68 *Texas Law Review* 865 at 934.

8 'The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law' (1990) 68 *Texas Law Review* 865 at 934.

[3.31]

Others, besides progressives (communitarians) and pluralists, have criticised the shareholder value theory on a number of varied grounds. First, it can be argued that shareholders do not have effective control of

managers[1] and so directors cannot be seen as being accountable to them. This means that the theory is not workable because directors are not always going to be held responsible if they shirk and fail to foster shareholder maximisation. Even if it can be said that there is some shareholder control of directors, it will usually be vested in those with the largest shareholdings and the control, therefore, may not bring benefits to those with small holdings. The fact is that to be in real control the shareholders would have to be able to make decisions that affect the benefits of other contributors to the company[2]. Arguably they cannot.

1 See A Keay 'Company Directors Behaving Poorly: Disciplinary Options for Shareholders' [2007] JBL 656.

2 L Zingales 'In Search of New Foundations' (2000) 55 *Journal of Finance* 1623 at 1632.

[3.32]

Secondly, it has been argued that shareholder value does not really increase social wealth[1]. It merely benefits shareholders, and only, perhaps, some of the shareholders. For in seeking to pursue shareholder value, the company might fail to be able to meet its obligations and all stakeholders will suffer. Also, in achieving shareholder value, a company might find that it is appropriate to engage in externalising, that is, transferring value away from one or more stakeholders, eg closing down a factory and making some employees redundant. Finally on this point, while promoting shareholder value might lead indirectly to benefits for other stakeholders, the promotion of this approach might lead to financial difficulty and that will adversely affect all other investors.

1 P Joerg, C Loderer, L Roth and U Waelchli 'The Purpose of the Corporation: Shareholder-value Maximization?' European Corporate governance Institute Finance Working Paper No 95/2005, February 2006 and available at http://ssrn.com/abstract=690044.

[3.33]

Thirdly, if one accepts the concept of a nexus of contracts, there are surely many persons who constitute the nexus that can be said to be residual claimants. The shareholders are not necessarily the ones most affected by a company's decisions[1]. For example, employees invest firm-specific human capital in the company and this may place them in a position where they are vulnerable to management caprice[2].

1 L Zingales 'In Search of New Foundations' (2000) 55 *Journal of Finance* 1623 at 1632; M Blair and L Stout 'Specific Investments and Corporate Law' presented by Lynn Stout at the Corporate Law Teachers' Conference on 6 February 2006 at the University of Queensland, Brisbane, Australia at 15.

2 See M O'Connor 'The Human Capital Era' (1993) 78 Cornell L Rev 899 at 905–917.

[3.34]

Fourthly, it has been argued that the shareholder value principle is not relevant to business decisions today and that it was introduced originally to resolve disputes among majority and minority shareholders in closely-held (private) companies, and courts tended not to distinguish between closely-held and public companies until the middle of the last century[1].

1 D Gordon Smith 'The Shareholder Primacy Norm' (1998) 23 *Journal of Corporation Law* 277 at 279.

[3.35]

Fifthly, the shareholder value theory does not allow for the fact that many investors are diversified and will be both shareholders and creditors (often bondholders) in companies[1]. Those in this situation are not going to have the same goals as those who are purely shareholders. Shareholders who have diversified interests will be looking for a more balanced approach to the making of investment and other decisions that directors have to make.

[1] T Smith 'The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty' (1999) 98 *Michigan Law Review* 214 at 217.

[3.36]

One of the main criticisms that are espoused by advocates of shareholder value when it comes to a consideration of stakeholder theory (to which we come shortly) is that the latter does not provide managers with any guidance as to how they should manage, with no aim being set, and in fact it could provide an opportunity for managers to shirk or self-deal. Yet the shareholder value paradigm is itself able to be criticised on the basis that the goal is ill-defined to start with[1]. The reason is that different shareholders will have different aims and so it is not clear what managers should actually be doing. There is the problem of whether short-term or long-term horizons should be set[2]. Professor Eric Orts has said that 'shareholders have different time and risk preferences that managers must somehow factor together, if they are to represent fairly the artificially unified interest of “the shareholders” in general'[3]. Clearly short-term and long-term strategies differ. Orts gives the example of drastic cost-cutting that might achieve short-term results by improving the bottom line for a short while, but in the long-run this might deleteriously affect the company's business[4].

[1] P Joerg, C Loderer, L Roth and U Waelchli 'The Purpose of the Corporation: Shareholder-value Maximization?' European Corporate governance Institute Finance Working Paper No 95/2005, February 2006 and available at http://ssrn.com/abstract=690044. See A Keay 'Getting to Grips with the Shareholder Value Theory in Corporate Law' (2010) 39 *Common Law World Review* 358.

[2] See H Hu 'Risk, Time and Fiduciary Principles in Corporate Investment' (1990) 38 UCLA L Rev 277.

[3] 'The Complexity and Legitimacy of Corporate Law' (1993) 50 *Washington and Lee Law Review* 1565 at 1591.

[4] 'The Complexity and Legitimacy of Corporate Law' (1993) 50 *Washington and Lee Law Review* 1565 at 1592.

[3.37]

Sixthly, while some have acknowledged the fact that shareholder value provides a convenient common metric, it is too glib to reduce everything to a matter of profit, as, it is argued, the theory does[1]. Many see the theory as cold and uncaring and totally omitting the human dimension that is critical to all facets of life, including business.

[1] D Wood 'Whom Should Business Serve?' (2002) 14 *Australian Journal of Corporate Law* 1 at 13.

[3.38]

Finally, there have been indications from time to time that in practice directors do not solely focus on shareholder value as their aim. An empirical study of 50 FTSE 100 companies seems to support that view to some degree[1]. Before completing this section, it would be remiss of me not to mention the fact that many, if not the vast majority of, shareholder value theorists take the view that shareholder primacy does not mean ignoring the interests of other stakeholders. It is often argued that it is necessary for the directors to take into account the interests of various stakeholders, although the ultimate benefit must be for the shareholders.

1 A Keay and R Adamopoulou 'Shareholder Value and UK Companies: A Positivist Inquiry' (2012) 13 *European Business Organization Law Review* 1.

2 From a positive perspective: What do the cases say?

[3.39]

Notwithstanding that there are many assertions that the historical position of the courts in the UK is to favour the shareholder value approach, a study of UK case law does not show an unequivocal acceptance of this approach[1]. More often than not the courts have been content to say that the duties of the directors are owed to the company, something that s 170 of the CA 2006 states, as we will consider in CHAPTER 4. What does it mean to say that duties are owed to the company? As pointed out by Nourse LJ in *Brady v Brady*[2], this is an expression that is often used, but is rarely defined, and it is probably one of the most problematical expressions in company law. His Lordship opined that it was sometimes misunderstood. Professor Dan Prentice has referred to the phrase as being 'indeterminate'[3], and another commentator has said that it was 'unclear'[4]. Does the expression mean that the directors are to act in the best interests of the shareholders, or do broader interests have to be considered? Notwithstanding the comments about the lack of clarity with the expression, the Company Law Review Steering Group stated that the directors are to manage the company's business for the benefit of the company, and this normally means that it is managed for the benefit of the shareholders as a whole[5].

1 Parts of the discussion under this heading are taken from A Keay 'Enlightened Shareholder Value, the Reform of the Duties of Company Directors and the Corporate Objective' [2006] LMCLQ 335 at 341–345.

2 *(1987) 3 BCC 535 at 552*.

3 D D Prentice 'Creditor's Interests and Director's Duties' (1990) 10 OJLS 265 at 273.

4 J Heydon 'Directors' Duties and the Company's Interests' in P Finn (ed) *Equity and Commercial Relationships* (Sydney, Law Book Co, 1987) at 122.

5 Company Law Review, *Modernising Company Law: The Strategic Framework* (London, DTI, 1999) at para 5.1.5; B Hannigan *Company Law* (London, LexisNexis Butterworths, 2003) at 203.

[3.40]

The phrase has been employed by judges in several corporate law areas and not only when hearing cases involving the exercise of directors' duties[1]. For instance, it is part of the test that is used when assessing whether an alteration to the articles of association of a company is permissible[2], and some of those cases will be referred to below.

1 For instance, see *Re Smith & Fawcett Ltd [1942] Ch 304 at 306, 308 (CA).*

2 For instance, see *Allen v Gold Reefs of West Africa Ltd [1900] 1 Ch 656 at 671*.

[3.41]

One of the first indications that shareholder value was to be the focus of directors of companies in UK law came with the comments of Jessel MR in *Re Wincham Shipbuilding*[1] in 1878. His Lordship (with the concurrence of James and Bramwell LJJ), after asking the question, for whom are the directors trustee, said that 'the directors are trustees for the shareholders, that is, for the company'[2]. Shortly after that case, *Hutton v*

West Cork Railway Co[3] was decided (by a differently constituted Court of Appeal) and it is often cited as supporting shareholder value. It is also well known for the classic statement by Bowen LJ that: 'The law does not say that there shall be no cake and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.[4]' The fact is that the court did not make a specific statement concerning the identity of the beneficiaries of the directors' management efforts. The court was concerned that any action was taken for the benefit of the company, and the court did not, it appears, notwithstanding the assertions of a number of writers[5], state that this meant benefitting the shareholders' interests. The case does not stand unequivocally for shareholder value.

1 *(1878) LR 9 Ch D 322*.

2 (1878) LR 9 Ch D 322 at 328. Such a view was posited in New Zealand in *Re H Linney & Co Ltd [1925] NZLR 907 at 922*. In more recent times the idea that directors are trustees has been exploded. For instance, see L S Sealy 'The Director as Trustee' [1967] CLJ 83. However, even more recently reference has still been made to directors acting as trustees. For instance, see Lord Cullen in *Dawson International plc v Coats Paton plc (No 1)* 1988 SLT 854 at 858, [1989] BCLC 233 at 237.

3 *(1883) 23 Ch D 654*.

4 (1883) 23 Ch D 654 at 673.

5 For instance, J MacIntosh 'Designing an Efficient Fiduciary Law' (1993) 43 *University of Toronto Law Journal* 425 at 452.

[3.42]

As mentioned above, there are many cases that have considered the meaning of the expression in the context of dealing with whether an alteration to the articles of association was in the best interests of the company as a whole[1]. In one of the cases that is said to provide the strongest support for a shareholder value interpretation, *Greenhalgh v Arderne Cinemas*[2], Lord Evershed MR, with whose judgment the other members of the Court of Appeal agreed, said that the phrase 'interests of the company as a whole' did not mean the company as a commercial entity, but rather it meant the corporators as a general body[3]. It is interesting to note that his Lordship had said something quite different only a few years earlier, in *Short v Treasury Commissioners*[4]: 'Shareholders are not in the eyes of the law, part owners of the undertaking. The undertaking is something different from the totality of its shareholding'. The approach espoused in *Greenhalgh* might be said to be consistent with what Dixon J said in the Australian High Court case of *Peters American Delicacy v Heath*[5], where his Honour said that the company as a whole is a corporate entity consisting of all of the shareholders[6]. Yet, it must not be forgotten that these cases, and all the cases dealing with an alteration to the articles are referring to how the members of the company are to act, and not the directors. Only directors are subjected under UK law to fiduciary duties. Furthermore, the cases dealing with the articles are not addressing the issue of: to whom are duties owed. But, there is authority involving consideration of directors' duties, such as *Parke v Daily News Ltd*[7], where it has been said that the benefit of the company meant the benefit of the shareholders as a general body[8]. Then in *Gaiman v National Association for Mental Health*[9], Megarry J said that 'it is not very easy to determine what is in the best interests of the [company] without paying due regard to the members of the [company]'[10]. His Lordship went on to say that he regarded the expression to mean the interests of present and future shareholders as a whole.

1 For example, see *Allen v Gold Reefs of West Africa Ltd [1900] 1 Ch 656*; *Sidebottom v Kershaw Leese and Co Ltd [1921] 1 Ch 154*; *Shuttleworth v Cox Bros and Co (Maidenhead) Ltd [1927] 2 KB 9*.

2 *[1951] Ch 286*.

3 [1951] Ch 286 at 291.

4 *[1948] 1 KB 116 at 122*.

5 *(1939) 61 CLR 457*.

6 The difficulties with the 'benefit of the company as a whole' test caused the Australian High Court in *Gambotto v WCP Ltd (1995) 182 CLR 432*, to say that it was time that the test was dispensed with. But the Company Law Review Steering Group felt that that the test was too well-established in English law, and should be retained (*Modern Company Law for a Competitive Economy: Completing the Structure* (London, DTI, 2000) at paras 5.94–5.99; Company Law Review, *Modern Company Law for a Competitive Economy: Final Report* (London, DTI, 2001) vol 1, at paras 7.52–7.62).

7 *[1962] Ch 927*.

8 [1962] Ch 927 at 963.

9 *[1971] Ch 317*.

10 [1971] Ch 317 at 330.

[3.43]

Perhaps one of the clearest statements to favour shareholder value was emitted by Nourse LJ in *Brady v Brady*[1]. His Lordship said[2]:

> ''The interests of a company, an artificial person, cannot be distinguished from the interests of the persons who are interested in it. Who are those persons? Where a company is both going and solvent, *first and foremost* come the shareholders, present and no doubt future as well.' (my emphasis)'

1 *(1987) 3 BCC 535*.

2 (1987) 3 BCC 535 at 552.

[3.44]

However, the case was essentially dealing with whether there had been a breach of CA 1985, s 151 (now CA 2006, s 678), the provision that prohibited the giving of financial assistance by a company in the purchase of its shares, and not directors' duties, so while it is of some assistance it is not directly on point.

[3.45]

Notwithstanding the comments supporting shareholder value, there are cases in which judges have played down the pre-eminence of shareholders' interests. The shareholder value paradigm was indirectly questioned by Lord Diplock in *Lonrho Ltd v Shell Petroleum Co Ltd*[1], where he stated, by way of obiter, that[2]:

> ''[I]t is the duty of the board to consider whether to accede to the request [for inspection of documents] would be in the best interests of the company. These are not exclusively those of its shareholders but may include those of its creditors.''

The other four Law Lords concurred with his Lordship's speech.

1 *[1980] 1 WLR 627*.

2 [1980] 1 WLR 627 at 634.

[3.46]

More recently the Court of Appeal in *Fulham Football Club Ltd v Cabra Estates plc*[1] appeared to adopt a similar approach when it stated that 'the duties owed by the directors are to the company and the company is more than just the sum total of its members'[2].

1 *[1994] 1 BCLC 363*.

2 [1994] 1 BCLC 363 at 379.

[3.47]

Many of the cases[1] that have been regarded as holding that directors must act for shareholders, do not in fact support that proposition. The courts in these cases have said that directors might owe fiduciary duties to the shareholders where special circumstances exist, such as when the company is the subject of a takeover offer[2]. Absent special circumstances, directors clearly do not owe such duties to shareholders[3], save perhaps in small family companies[4]. Take the judgment in the Scottish case of *Dawson International plc v Coats Paton plc (No 1)*[5] for example. It was stated in that case that the directors were, in conducting the affairs of the company and discharging their duties, to consider the interests of the company[6]. The court said that directors owed no general fiduciary duty to shareholders, although directors might become subject to a duty to shareholders if they were to make recommendations to the shareholders in light of a takeover offer, for if directors took the decision to recommend the acceptance of that offer they had a duty (which might be called a secondary fiduciary duty) to the shareholders[7].

1 For instance, see *Heron International Ltd v Lord Grade [1983] BCLC 244*; *Peskin v Anderson* [2000] BCC 1110, *[2000] 2 BCLC 1* (and affirmed on appeal by the Court of Appeal [2001] BCC 874).

2 For instance, see *Gething v Kilner [1972] 1 WLR 337*, *[1972] 1 All ER 1166*; *Re a Company [1986] BCLC 382*; *Brunninghausen v Glavanics [1999] NSWCA 199, (1999) 17 ACLC 1247*.

3 For example, see *Dawson International plc v Coats Paton plc (No 1)* 1988 SLT 854, [1989] BCLC 233. Also, see *Platt v Platt [1999] 2 BCLC 745*.

4 See *Coleman v Myers [1977] 2 NZLR 225*.

5 1988 SLT 854, [1989] BCLC 233.

6 1988 SLT 854 at 860, [1989] BCLC 233 at 241.

7 1988 SLT 854 at 859, [1989] BCLC 233 at 240. This was acknowledged in *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204*; *Gething v Kilner [1972] 1 WLR 337*, *[1972] 1 All ER 1166*.

[3.48]

The equivocal position that appears to exist in the UK, seems to reflect the experience in other parts of the Commonwealth. In the New Zealand Court of Appeal in *Nicholson v Permakraft (NZ) Ltd*[1] Cooke J indicated that the duties of creditors are owed to the company, and he went on to say unequivocally that directors had to act in the best interests of the company as a whole[2]. There are comments by Latham CJ and Dixon J in the Australian High Court case of *Richard Brady Franks Ltd v Price*[3] that support the notion that we are talk-

ing about the shareholders when we say that directors are to act in the best interests of the company. In *Kinsela v Russell Kinsela Pty Ltd*[4], Street CJ of the New South Wales Court of Appeal stated that when a company is solvent, 'the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise'[5]. But, other courts have been more precise. In a post-*Kinsela* New South Wales Court of Appeal case, *Brunninghausen v Glavanics*[6], Handley JA said that: 'The general principle that a director's fiduciary duties are owed to the company and not to shareholders is undoubtedly correct …'. The British Columbia Court of Appeal in *Canadian Metals Exploration Ltd v Wiese*[7] said that duties are owed to the company and not the shareholders.

1 *(1985) 3 ACLC 453 at 459*.

2 (1985) 3 ACLC 453 at 462.

3 *[1937] HCA 42*, *(1937) 58 CLR 112*.

4 *(1986) 4 ACLC 215*, *(1986) 10 ACLR 395*.

5 (1986) 4 ACLC 215 at 221, (1986) 10 ACLR 395 at 401.

6 *[1999] NSWCA 199*, *(1999) 17 ACLC 1247 at [43]*.

7 *[2007] BCCA 318 (CanLII) at [28]*.

[3.49]

In *Peoples' Department Stores v Wise*[1] Canada's highest court, the Supreme Court of Canada, said that directors had a duty to act in the best interests of the corporation and that 'the best interests of the corporation' meant acting to maximise the value of the corporation. Major and Deschamps JJ, in delivering the judgment of the court, specifically stated that the expression acting in the 'best interests of the corporation' does not mean acting in the best interests of the shareholders or any one stakeholder's interests[2]. The judges went on to say that[3]:

> ''But if they [the directors] observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not … leave directors open to the charge that they have failed in their fiduciary duty to the company … We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of the shareholders, employees, suppliers, creditors, consumers, governments and the environment … At all time, directors and officers owe their fiduciary duties to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.''

1 *[2004] SCC 68*, *(2004) 244 DLR (4th) 564*.

2 [2004] SCC 68, (2004) 244 DLR (4th) 564 at [42].

3 [2004] SCC 68, (2004) 244 DLR (4th) 564 at [42]–[43].

[3.50]

Subsequently, in *BCE Inc v 1976 Debentureholders*[1] the Canadian Supreme Court followed the approach taken in *Peoples' Department Stores* and said that: 'There is no principle that one set of interests – for example the interests of shareholders – should prevail over another set of interests.[2]'

[1] *[2008] SCC 69.*

[2] [2008] SCC 69 at [84].

[3.51]

In the Australian case of *Darvall v North Sydney Brick and Tile Company Ltd*[1], the judge, Hodgson J, tried to cover all bases and said that it is proper for directors to have regard for the interests of the shareholders as well as having regard for the company as a commercial entity. He also felt that creditors' interests should be taken into account[2].

[1] *(1988) 6 ACLC 154.*

[2] (1988) 6 ACLC 154 at 176.

[3.52]

In sum, there is not a clear strain of authority running through UK or Commonwealth case law supporting the shareholder value principle. Undoubtedly some cases suggest that the focus should be on shareholders, while others either merely blandly state that the directors are to act in the interests of the company, or indicate that the interests of the company involves something more than the interests of shareholders.

Directors' Duties/Chapter 3 Directors in the Corporate Governance Process/III To whom are duties owed?/B Stakeholder theory

B Stakeholder theory

[3.53]

This is the second major theory that exists. Under this theory it is advocated that the duties of directors of companies are owed to a range of people. Directors have a responsibility to create optimal value for all parties affected by a company's decisions[1], consequently they owe duties to all stakeholders[2].

[1] R E Freeman *Strategic Management: A Stakeholder Approach* (Boston, Pitman/Ballinger, 1984).

[2] M Clarkson 'A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance' (1995) 20 *Academy Management Review* 92 at 112. For a detailed discussion, see A Keay 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' (2010) 9 *Richmond Journal of Global Law & Business* 249.

[3.54]

There clearly was some incipient form of stakeholder theory in company law evident throughout much of the twentieth century. It can be seen in the work of Harvard University law professor, E Merrick Dodd in the early 1930s[1], the approach of successful American companies (who referred to stakeholder management) in the

1920s to the 1950s[2], many of the directors of which employed managerial theory, and the work of the reformer, Ralph Nader, in the 1960s and 1970s. However, the development of the theory is usually traced to Professor Edward Freeman, an organisational behaviour academic, and particularly to his book, *Strategic Management: a stakeholder approach*, published in 1984[3]. Of course, stakeholder theory in broader social terms has been invoked by several theorists for a great number of years, and one can trace it back to the work of a German social theorist, Johannes Althusius, in the seventeenth century[4].

[1] Dodd said that the advancing of the interests of stakeholder groups such as employees and customers as well as the general community seemed to be less abnormal than shareholder value ('Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?' (1934) 2 U Chi LR 194 at 199).

[2] See L Preston and H Sapienza 'Stakeholder Management and Corporate Performance' (1990) 19 *Journal of Behavioral Economics* 361 at 362.

[3] Boston, Pitman/Ballinger, 1984.

[4] E Orts 'A North American Legal Perspective on Stakeholder Management Theory' in F Patfield (ed) *Perspectives on Company Law* (Kluwer, 1997) vol 2, at 170.

[3.55]

In his book Freeman called for a re-think about business organisations, arguing that economic theories that had been pre-eminent were outdated. His view was that there are more than just shareholders who contribute to a company, and they can be referred to as stakeholders[1] or constituencies. Some of these stakeholders do not have contractual protection and it was argued that their interests deserve consideration by directors in how they manage the company, in what decisions they make and how their duties are to be exercised. So, stakeholder theory rejects the idea of maximising a single objective, as one gets with shareholder value.

[1] The term 'stakeholder' is said to have its genesis in a 1963 Stanford Research Institute memorandum where it was used to refer to 'those groups without whose support the organization would cease to exist': R E Freeman and D Reed 'Stockholders and Stakeholders: A New Perspective on Corporate Governance' (1983) 25 *California Management Review* 88 at 89.

[3.56]

As a normative thesis stakeholder theory holds to the legitimacy of the claims on the company that many different groups and people have and this justifies its implementation[1]. In other words, this theory is premised on the idea that in addition to shareholders other groups have claims on the property of companies as they contribute to its capital (in broad terms)[2]. This is often referred to as firm-specific capital.

[1] See T Donaldson and L Preston 'The Stakeholder Theory for the corporation: Concepts, Evidence, Implications' (1995) 20 *Academy Management Review* 65 at 66–67.

[2] R Karmel 'Implications of the Stakeholder Model' (1993) 61 *George Washington Law Review* 1156 at 1171.

[3.57]

Under the stakeholder theory it is advocated that the duty of directors of companies is to create optimal value for all social actors who might be regarded as parties affected by a company's decisions[1]. The argument is that all stakeholders have a right to be regarded as an end and not a means to an end[2]. So, the company should be managed for the benefit of all of its stakeholders: its customers, suppliers, creditors, shareholders, employees, the tax authorities, the natural environment and local communities in which the company operates. The rights of these groups must be ensured, and, further, the groups must participate, in some sense,

in decisions that substantially affect their welfare[3]. Stakeholding has been said to be a matter or 'taming' the 'harsher aspects of capitalism'[4].

[1] R E Freeman *Strategic Management: A Stakeholder Approach* (Boston, Pitman/Ballinger, 1984).

[2] R E Freeman *Strategic Management: A Stakeholder Approach* (Boston, Pitman/Ballinger, 1984) at 97.

[3] W Evans and R E Freeman 'A Stakeholder Theory of the Modern Corporation: Kantian Capitalism' in T Beauchamp and N Bowie (eds) *Ethical Theory and Business* (Englewood Cliffs, NJ, Prentice-Hall, 1988) at 103.

[4] J Plender *The Stakeholding Solution* (London, Nicholas Brealey, 1997) referred to in J Dean *Directing Public Companies* (London, Cavendish, 2001) at 117.

[3.58]

The theory is embraced by many who hold to a managerialist approach to companies. They believe that managers are at the centre of companies and they advocate wide powers being given to managers who can be trusted to act as stewards of the company and its affairs[1].

[1] Unlike many communitarians who eschew economics and focus solely on ethics and fairness, stakeholder theory as advocated by managerialists seeks to combine economics and ethics.

[3.59]

The adherents to this theory have advocated concepts of individual autonomy and fairness to all members of society[1]. The theory holds to equality of stakeholders in that they are entitled morally to be considered in the management of the company's affairs and to be considered simultaneously[2]. It has been asserted that: 'The economic and social purpose of the corporation is to create and distribute wealth and value to all its primary stakeholder groups, without favoring one group at the expense of others.[3]' In comparison with shareholder value, no grouping has automatic priority over another[4].

[1] For example, J Boatright 'Fiduciary Duties and the Shareholder-Management Relation: Or, What's So Special about Shareholders?' (1994) 4 *Business Ethics Quarterly* 393.

[2] R Mitchell 'Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts' (1997) 22 *Academy Management Review* 853 at 862.

[3] M Clarkson 'A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance' (1995) 20 *Academy Management Review* 92 at 112.

[4] T Donaldson and L Preston 'The Stakeholder Theory for the Corporation: Concepts, Evidence, Implications' (1995) 20 *Academy Management Review* 65.

[3.60]

Those who would advocate stakeholder theory vary in thinking, so what is considered here can only be regarded as the views held by the majority of scholars and practitioners of the theory. As far back as the 1920s Owen Young, the President of General Electric said that he acknowledged that he had an obligation to the stockholders to pay a fair rate of return, but he said that he also had an obligation to labour, customers and the public[1]. The chairman of the US company, Standard Oil, stated, in 1946, that the business of companies should be carried on 'in such a way as to maintain an equitable and working balance among the claims of the

various directly interested groups – stockholders, employees, customers and the public at large'[2]. More recently, a corporate reputation survey of *Fortune 500* companies (the largest listed companies in the US) found that satisfying the interests of one stakeholder does not automatically mean that this is at the expense of other stakeholders[3]. This is supported by empirical evidence, obtained in a study by the *Financial Times of Europe*'s most respected companies, which found that chief executive officers were of the view that one of the features of a good company was the ability to ensure that there was a balancing of the interests of stakeholder groups[4]. Chancellor William Allen (as he then was) of the Delaware Chancery Court in the US said extra-judicially that the dominant view among leaders for the past 50 years has been that no single constituency's interests should exclude the interests of other constituencies from the fair consideration of the board[5]. As mentioned earlier, an empirical study of 50 FTSE 100 companies in the UK suggests that a good percentage of listed companies do take into account stakeholder interests in the decisions that they make, and shareholder primacy might not be as prominent as is often thought[6].

[1] E Merrick Dodd 'For Whom are Corporate Managers Trustees?' (1932) 45 Harv LR 1145 at 1154.

[2] Quoted in M Blair *Ownership and Control* (Washington DC, The Brookings Institute, 1995) at 212.

[3] L Preston and H Sapienza 'Stakeholder Management and Corporate Performance' (1990) 19 *Journal of Behavioral Economics* 361.

[4] Referred to in E Scholes and D Clutterbuck 'Communication with Stakeholders: An Integrated Approach' (1998) 31 *Long Range Planning* 227 at 230.

[5] 'Our Schizophrenic Conception of the Business Corporation' (1992) 14 Cardozo LR 261 at 271.

[6] A Keay and R Adamopoulou 'Shareholder Value and UK Companies: A Positivist Inquiry' (2012) 13 *European Business Organization Law Review* 1.

[3.61]

One of the major problems that the theory faces is that it is not always clearly articulated and has been a difficult concept to define[1]. It has been said that stakeholding is 'a slippery creature … used by different people to mean widely different things which happen to suit their arguments'[2].

[1] M Omran, P Atrill and J Pointon 'Shareholders Versus Stakeholders: Corporate Mission Statements and Investor Returns' (2002) 11 *Business Ethics: A European Review* 318 at 318.

[2] M V Weyer 'Ideal World' (1996) *Management Today*, September, 35 at 35.

[3.62]

Freeman et al say that the best deal for everyone is if the company is run in such a manner that as much value for stakeholders as possible is created[1]. Shareholder value advocates say similar things, but get there via a different route.

[1] R E Freeman, A C Wicks and B Parmar 'Stakeholder Theory and the Corporate Objective Revisited' (2004) 15 *Organization Science* 364 at 365.

[3.63]

Some suggest that if stakeholding were employed it would enhance the company's reputation and lead others to feel that their company operates on principle and can be trusted. All of this would benefit everyone involved[1]. So for a company to thrive it must: produce competitive returns for shareholders; satisfy customers in order to produce profits; recruit and motivate excellent employees; build successful relationships with suppliers[2]. It has been asserted that stakeholding is the instrument through which efficiency, profitability, competition and economic success can be promoted on the basis that if one removed cohesion among stakeholders it would not be possible for companies to be competitive[3].

[1] J Dean *Directing Public Companies* (London, Cavendish, 2001) at 108.

[2] J Dean *Directing Public Companies* (London, Cavendish, 2001) at 251.

[3] A Campbell 'Stakeholders, the Case in Favour' (1997) 30 *Long Range Planning* 446 at 446.

[3.64]

Probably more can be learned about the theory from the criticisms that have been aimed at it. Some critical comments are very broad, such as those of Elaine Sternberg, a shareholder value theorist. She argues that stakeholder theory is 'deeply dangerous and wholly unjustified'[1]; on the basis that it 'undermines private property, denies agents' duties to principals, and destroys wealth'[2].

[1] 'The Defects of Stakeholder Theory' (1997) 5 *Corporate Governance: An International Review* 3 at 6.

[2] 'The Defects of Stakeholder Theory' (1997) 5 *Corporate Governance: An International Review* 3 at 9.

[3.65]

As mentioned above, the theory has not been clearly defined, and notwithstanding the fact that many years have now passed since Freeman introduced the theory and there are many attractive elements to it, we have yet to see a robust and workable theory formulated, certainly one that can be implemented in practice. Many proposals have been propounded but they have tended to rely on 'a serious mismatch of variables which are mixed and correlated almost indiscriminately with a set of stakeholder-related performance variables that are not theoretically linked'[1].

[1] D J Wood and R E Jones 'Stakeholder Mismatching: A Theoretical Problem in Empirical Research on Corporate Social Performance' (1995) 3(3) *The International Journal of Organizational Analysis* 229 at 231.

[3.66]

One of the main difficulties has been in identifying and defining who are in fact stakeholders[1]. Definitions have varied, from the narrow to the very broad. Probably the first articulation of the concept was provided in an internal memorandum at the Stanford Research Institute in 1963[2], which said that stakeholders were: 'Those groups without whose support the organisation would cease to exist'. Freeman built on this and in 1984 defined them as 'any group or individual who can affect or is affected by the achievement of the organisation's objectives'[3]. This broadens the category of stakeholders to include governments, customers, the environment, while in the past employees had tended to be the focus of those wanting a broader perspective in management[4]. The criticism is that managers are given no basis for identifying who are stakeholders. Furthermore, some stakeholders are more important than others, but there is no guidance to determine who is the more important[5]. And as Leung has said: 'there is no easy way to delineate the stakeholder class'[6]. There are a huge number of potential stakeholders and the problem for a board is to determine how they are to address the needs of groups with divergent interests[7]. The stakeholder case has probably been harmed by the fact that Freeman included terrorist groups as stakeholders in some companies (on the basis that they can

affect how companies are run)[8]. Many have sought to distance the theory from this approach. Some commentators have said that one must distinguish between those who influence the company and those who are true stakeholders. Some groups are in both categories. But the media, for instance, is in the first category only[9]. Other commentators have distinguished between primary and secondary stakeholders, with the former being the focus of directors. Primary stakeholders are seen as those who have a formal, official or contractual relationship with the company[10].

[1] Mitchell and his co-authors in 'Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts' (1997) 22 *Academy Management Review* 853 at 858 identify 27 definitions of stakeholders.

[2] Referred to by Freeman in his book, *Strategic Management: A Stakeholder Approach* (Boston, Pitman/Ballinger, 1984) at 31.

[3] Freeman, *Strategic Management: A Stakeholder Approach* (Boston, Pitman/Ballinger, 1984) at 246.

[4] Often advocating some forms of industrial democracy or even advocating the embracing of something similar to German co-determinism.

[5] A Sundaram and A Inkpen 'The Corporate Objective Revisited' (2004) 15 *Organization Science* 350 at 352.

[6] W Leung 'The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime that Recognizes Non-Shareholder Interests' (1997) 30 *Columbia Journal of Law and Social Problems* 589 at 622.

[7] W Leung 'The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime that Recognizes Non-Shareholder Interests' (1997) 30 *Columbia Journal of Law and Social Problems* 589 at 621.

[8] R E Freeman *Strategic Management: A Stakeholder Approach* (Boston, Pitman/Ballinger, 1984) at 53.

[9] T Donaldson and L Preston 'The Stakeholder Theory for the Corporation: Concepts, Evidence, Implications' (1995) 20 *Academy Management Review* 65 at 86.

[10] A Carroll *Business and Society* (Cincinnati, South-Western Publishing, 1993) at 62.

[3.67]

Perhaps the primary argument that is mounted against stakeholder approach is that in discharging their duties the directors have to balance the interests of all stakeholders and that is an impossible task. Even stakeholder theorists accept that stakeholder management involves 'a never-ending task of balancing and integrating multiple relations and multiple objectives'[1]. Sternberg agrees with this comment (although coming to a different conclusion) and she has said that the 'essential principle of stakeholder theory that corporations are accountable to *all* their stakeholders' is something that is 'unworkable'[2].

[1] R E Freeman and J McVea 'A Stakeholder Approach to Strategic Management' in M Hitt et al (eds) *Handbook of Strategic Management* (Wiley-Blackwell, 2001) at 194.

[2] E Sternberg 'The Defects of Stakeholder Theory' (1997) 5 *Corporate Governance: An International Review* 3 at 6.

[3.68]

Another leading argument against the theory, and based on the notion that directors have to consider many interests, is that it is likely to lead directors to opportunistic activities and shirking, because directors end up being accountable to no one (known as the 'too many masters' problem)[1]:

> "A manager who is told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither … Agency costs rise and social wealth falls."

[1] F Easterbrook and D Fischel *The Economic Structure of Company Law* (Cambridge, Mass, Harvard University Press, 1991) at 38.

[3.69]

The concern for many is that directors can play off one group against another; they can say that after balancing interests they made a decision to benefit stakeholders X and Y, and this decision just happened to benefit or protect the directors themselves. It is difficult to impugn such a decision. Putting it another way, many commentators say that requiring managers to consider the interests of all constituencies 'is essentially vacuous, because it allows management to justify almost any action on the grounds that it benefits some group'[1]. In such a system the directors are arguably given too much of an unfettered discretion that cannot be monitored. Goyder says that in adopting stakeholderism in lieu of shareholder value one is sacrificing clarity for blancmange[2], presumably because blancmange is difficult to get hold of and can be moulded to anything one wishes. The riposte from the stakeholder adherents is that you have to rely upon the professionalism and trustworthiness of the directors. This really then comes down to a philosophical debate. Many in the shareholder value school says that you cannot trust directors because human nature is such that it will want to seek benefits at every possible turn (and you must have tight monitoring measures in place), whereas most in the stakeholder theory school states that while there will be some improper actions by directors, generally they will be fair and can be trusted.

[1] O Hart 'An Economist's View of Fiduciary Duty' (1993) 43 *University of Toronto Law Journal* 299 at 303.

[2] M Goyder *Living Tomorrow's Company* (London, Gower, 1998) at 3.

[3.70]

Another major problem with stakeholder theory is enforcing any breach by directors. Do you give the power to anyone to bring proceedings or do you limit it to specific constituencies? We will see later in the book that the law has grappled with the whole idea of allowing a party, other than the company itself, to bring proceedings where directors have not done their jobs properly or have acted in an improper way. Legislation now permits shareholders to bring what are known as 'derivative claims' for the company in such circumstances (discussed in Chapter 14), but the Government has not countenanced the possibility of any other stakeholders being given that right. And it is highly unlikely that it will, certainly in the short-medium term.

[3.71]

The approach of stakeholder theory is to incorporate important values as a critical aspect of the strategic management process, but the riposte from shareholder value advocates is: how do managers identify these values and in what way are they to inform decision-making?[1] They argue that arriving at a set of values that accounts for the concerns across a heterogeneous group of stakeholders requires managers to fulfil unrealistic expectations[2].

[1] A Sundaram and A Inkpen 'The Corporate Objective Revisited' (2004) 15 *Organization Science* 350 at 352, 353.

[2] A Sundaram and A Inkpen 'The Corporate Objective Revisited' (2004) 15 *Organization Science* 350 at 352.

[3.72]

Another difficulty that is identified because of the large number of constituencies that a company might have is that they will usually have conflicting claims, and each constituency will be subject to the opportunistic actions of other constituencies[1]. This complicates any decisions that the directors are to make in balancing interests.

[1] M Blair and L Stout 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247 at 276–287. The answer according to the learned commentators (pursuant to what they call 'the team production theory') is that the board must make the ultimate decisions in reconciling competing interests and disputes (at 276–277).

[3.73]

Finally, shareholder value scholars argue that non-shareholder stakeholders, such as creditors and employees are adequately protected, for the most part, by contract and/or statutory provisions and so if you require directors to take the interests of such constituencies into account they are receiving very special preferential treatment[1].

[1] See A Keay 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) 66 MLR 665.

Directors' Duties/Chapter 3 Directors in the Corporate Governance Process/III To whom are duties owed?/C Summary of theories

C Summary of theories

[3.74]

How duties are seen depends largely as to which corporate law theory one adheres to. Those taking a progressive or managerialist approach want to grant directors wide discretion, but also seek to have duties imposed on them to ensure there is significant regulation of what directors do. Conversely, those who advocate contractarian theories tend to use an economic analysis approach and duties are perceived as a contractual 'device uniquely crafted to fill in the massive gap in this open-ended bargain between shareholders and corporate officers and directors'[1]. It is said that 'the fiduciary principle is fundamentally a standard term in a contract'[2]. Providing a fiduciary duty is 'an alternative to elaborate promises and extra monitoring'[3]. All of this is to overcome the fact that contracts are seen as incomplete[4].

[1] J Macey 'An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties' (1991) 21 *Stetson Law Review* 23 at 41.

[2] F Easterbrook and D Fischel 'Corporate Control Transactions' (1982) 92 Yale L J 698 at 702.

[3] F Easterbrook and D Fischel *The Economic Structure of Corporate Law* (Harvard University Press, 1991) at 92.

[4] For a useful discussion of the concept, see I MacNeil 'Company Law Rules: An Assessment from the Perspective of Incomplete Contract Theory' (2001) 1 *Journal of Corporate Law Studies* 107. Also, see A Keay and H Zhang 'Incomplete Contracts, Contingent Fiduciaries and a Director's Duty to Creditors' (2008) 32 *Melbourne University Law Review* 141.

[3.75]

Historically in Anglo-American law and much of the law of the Commonwealth, shareholder value has held sway and directors have been seen as owing their duties to the shareholders. In practice, though, there are indications that directors have adopted a broader approach and embraced aspects of stakeholder theory[1]. Certainly many who adhere to shareholder value openly accept that directors must not ignore the interests of stakeholders as it is necessary to consider them in order for shareholders to be benefited ultimately.

1 South Africa is a good example.

[3.76]

Some of the issues discussed above were addressed by the Company Law Review Steering Group in its review of UK company law, and it plumped for what it saw as a different approach, namely enlightened shareholder value. This is discussed in detail in CHAPTER 6.

Directors' Duties/Chapter 3 Directors in the Corporate Governance Process/III To whom are duties owed?/D Duties to individual shareholders?

D Duties to individual shareholders?

[3.77]

No matter what approach one takes concerning to whom directors' duties are owed, clearly directors do not owe duties to the shareholders individually[1] except in special circumstances[2]. In *Peskin v Anderson*[3], while the Court of Appeal said that there was no duty owed to the shareholders in the case before it, it acknowledged the fact that there may be circumstances where there was a relationship between directors and shareholders that would lead to a fiduciary obligation existing[4]. Many of the cases in this area have related to share disposal transactions. It is also true to say that a fiduciary obligation might be owed to shareholders where a special relationship between the directors and the shareholders exists[5]. An example of this occurred in *Coleman v Myers*[6], a decision of the Court of Appeal in New Zealand, and one regularly cited by English courts, and approved of by Browne-Wilkinson V-C in *Re Chez Nico (Restaurants) Ltd*[7]. In the latter case it was held that a duty existed in the situation where the directors were acquiring shares in the company from shareholders. In *Sharp v Blank*[8] Nugee J applied the above approach to reject a claim by shareholders of Lloyds Bank that the directors of the Bank owed, and had breached, fiduciary duties to the shareholders. His Lordship acknowledged that duties are only owed to shareholders in a special factual relationship[9]. The judge went on to say[10]:

> "[T]his special relationship must be something over and above the usual relationship that any director of a company has with its shareholders. It is not enough that the director, as a director, has more knowledge of the company's affairs than the shareholders have: since they direct and control the company's affairs this will almost inevitably be the case. Nor is it enough that the actions of the directors will have the potential to affect the shareholders – again this will always, or almost always, be the case."

1 *Percival v Wright [1902] 2 Ch 421*; *Peskin v Anderson [2001] 1 BCLC 372 (CA).*

2 For instance, see *Gething v Kilner [1972] 1 WLR 337*, *[1972] 1 All ER 1166*; *Re a Company [1986] BCLC 382*; *Glandon Pty Ltd v Strata Consolidated Pty Ltd (1993) 11 ACSR 543 (NSWCA)*; *Brunninghausen v Glavanics [1999] NSWCA 199, (1999) 17 ACLC 1247.*

3 *[2001] 1 BCLC 372 (CA).*

4 [2001] 1 BCLC 372 (CA) at 379.

5 Robert Valentine has asserted that the courts should tread carefully in this area: 'The Director-Shareholder Fiduciary Relationship: Issues and Implications' (2001) 19 *Company and Securities Law Journal* 92 at 93.

6 *[1977] 2 NZLR 225*.

7 *[1992] BCLC 192 at 208*. Also, see *Platt v Platt* *[1999] 2 BCLC 745*.

8 *[2015] EWHC 3220 (Ch)*.

9 [2015] EWHC 3220 (Ch) at [10], [12].

10 [2015] EWHC 3220 (Ch) at [12].

Directors' Duties/Chapter 3 Directors in the Corporate Governance Process/III To whom are duties owed?/E Duties to creditors?

E Duties to creditors?

[3.78]

When a company is solvent the directors owe no duty to present or future creditors[1]. Some have argued that UK and Commonwealth case law can be read as supporting the fact that when a company is in financial difficulties, the directors owe fiduciary duties to the creditors of the company. While certain cases may be read in such a way, it is submitted that from a doctrinal point of view it would seem that this case law does not represent the law. There is a significant amount of case law in the UK, as well as in many Commonwealth countries and Ireland, to the effect that in certain circumstances, namely when the company is in financial straits, directors have to take into account the interests of creditors, but this obligation can only be seen as part of their duties to the company. The stronger view is that directors only owe an indirect duty to creditors, and not a direct independent duty. Nothing more will be said at this point as CHAPTER 13 is devoted to this whole matter, and it is better left until we reach that chapter.

1 *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd [1983] Ch 258 at 288*.

Directors' Duties/Chapter 3 Directors in the Corporate Governance Process/IV Agency theory

IV AGENCY THEORY

[3.79]

In a book dealing with directors, it behoves us to consider the agency theory, albeit briefly. It is a theory that is allied to the concept of separation of control and ownership, and adhered to by many corporate law academics and practitioners. The theory[1] seeks to examine the role of managers/directors inside the firm, as the company is often referred to, particularly by economists. The managers or directors are, pursuant to the agency theory, regarded as the agents of the shareholders in the running of the company's business[2], with

the latter being the principals. This relationship causes what is known as 'agency problems'. These result potentially from the fact that the shareholders and the managers have divergent interests. The theory maintains that mechanisms are required to ensure that the managers/directors, who are self-interest seeking parties, do not use their positions opportunistically to benefit themselves, or shirk their responsibilities to the detriment of shareholders. To resolve this problem there must be some co-alignment of incentives, and this co-alignment seeks to resolve a series of conflicting interests[3]. The mechanisms proposed by agency theory to mitigate director opportunism are, invariably, market based. The mechanisms include performance/profit based compensation, critical composition of independent directors on the board, the market of corporate control, the labour market for directors, as well as sufficient managerial ownership of the firm. The emphasis of agency analysis is on engendering incentive compatibility between directors and shareholders through market forces[4].

[1] M Jensen and W Meckling 'Theory of the Firm: Managerial Behaviour, Agency Costs, and Capital Structure' (1976) 3 *Journal of Financial Economics* 305.

[2] Case law does not support this. For example, see *Pascoe Ltd (in liq) v Lucas (1998) 16 ACLC 1247 at 1273.*

[3] Ways of effecting a co-alignment include providing incentive payments to managers and the market for corporate control.

[4] See A Keay and H Zhang 'Incomplete Contracts, Contingent Fiduciaries and a Director's Duty to Creditors' (2008) 32 *Melbourne University Law Review* 141.

[3.80]

A further problem facing the principals in the above relationship is that of information asymmetry, namely the principals and the agent do not have, or access to, the same information. The agents will have far more information than the principals because they are in control of the company. Agents can effectively choose what they will disclose to principals, and principals do have difficulty obtaining information and often knowing what information to try and obtain, and whether certain kinds of information actually exist. One of the ways of rectifying this is to have non-executive directors who are independent, sitting on boards to protect shareholders' interests, but that does not always work, witness the US company, Enron[1], where all but one of the members of the board were non-executive directors.

[1] The company, which had grown to be the seventh largest company in the US, collapsed later in 2001. The collapse of the company is seen as one of the greatest scandals in American corporate history. The losses of investors alone exceeded $70 billion.

[3.81]

The problems highlighted above, as well as other problems, produce agency costs, that is, the cost of overcoming agency problems. For instance, one way of resolving the problems mentioned is to ensure that there is adequate monitoring and disciplining of directors. However, that is costly and creates transactions costs.

[3.82]

The agency problem is, in effect, an incomplete contracting problem as it is not possible to lay down a contract that covers every conceivable contingency. The notion of one kind of duty owed by directors, the fiduciary duty, can be construed as a legal provision (along with other provisions) to 'complete' an incomplete contract between the principal and agent to a degree that the contract remains viable. Duties also can address the agency problem as they impose obligations on directors and give the company rights against the directors for breach.

V PROCESS

[3.83]

As one would expect, the way in which each company operates is likely to differ in some way. How a company operates is likely to depend on many factors, such as size of the company, size of the board, area of commerce and industry in which the company operates, and business goals.

[3.84]

Obviously various procedures and processes will be (or should be) formulated to enhance good corporate governance. As far as matters which require a formal decision of the board the process may typically involve[1], initially, the distribution of a briefing paper which commonly addresses all of those issues which the directors are likely to consider in making their decision, including, for instance: the strategic rationale for the proposal, the financial effects, a summary of legal and regulatory issues, issues relating to employees and factors that might affect the company's reputation. Naturally, how the paper is constructed will depend on the type of proposal that is involved. Before the relevant board meeting the paper will be disseminated amongst board members, except where the situation is exceptional. It might be argued that this paper represents the most important written support for the decision process. At the board meeting a presentation, in order to supplement the briefing paper, may be made. This will be followed by a discussion by the board members. After due deliberation the board will come to a decision.

[1] The following is based on Association of General Counsel and Company Secretaries of the FTSE 100 ('GC100') 'Companies Act (2006) – Directors' Duties' February 2007 at para 3.2(a).

[3.85]

A minute will be taken and it will usually summarise the main points of the board's discussion, as well as recording any decision that is made. It is possible that the minutes may include some sort of statement to the effect that, having taken into account all factors, the directors are of the view that the proposal is in the company's interests. However, it has been suggested that this approach only operates in situations where formal board minutes have to be disclosed to external third parties.

VI RECORDING ACTIONS AND DECISIONS

[3.86]

From a corporate governance perspective it is proper that directors keep appropriate and accurate records of the actions and decisions that they take from time to time. A large part of corporate governance, particularly as far as public companies and large private companies are concerned, is involved with the decisions that are made by directors in board meetings[1]. Besides perhaps enhancing corporate governance, there is another reason for making and retaining records. Directors must realise that they may well be called to account,

at any time, for their actions and decisions whilst a director of the company, but particularly if the company: enters some form of insolvency regime, the company is sold and another set of directors are appointed, or after their term of office ends. Not only must directors ensure that they discharge their duties properly and competently, they must ensure that this is recorded objectively so that they are able to resist any claims made against them, and to support their contention that they acted according to law. This is something that the board as a collective has to take into account. It is imperative that it ensures that there are records made and retained indicating why and how it made decisions and what actions it felt were appropriate in any given situation. Particularly it is critical that accurate and thorough minutes are taken at board meetings and meetings of committees of the board, such as the audit committee. The minutes should not only record the decisions made, but also the background discussions and rationales for any decisions taken.

[1] S Bottomley *The Constitutional Corporation* (Aldershot, Ashgate, 2007) at 68.

[3.87]

Also, it is important that directors have the opportunity to deliberate on issues and so processes should exist before the board meeting takes place that permits this to occur[1].

[1] S Bottomley *The Constitutional Corporation* (Aldershot, Ashgate, 2007) at 112.

[3.88]

At various points during the book, and especially in CHAPTER 6 and CHAPTER 8, comments will be made about record-keeping and other actions that ought to be taken by boards and individual directors.

[3.89]

Given the fact that it is not totally clear what is required of directors in discharging their duties under some provisions of the CA 2006, it is prudent that directors take every step they can to ensure that there is a record of what they have done and reasons provided for the actions taken (possibly with references to supporting evidence). Directors should carefully examine minutes of meetings and ensure that they are an accurate and faithful account of the meetings to which they relate, and that they record what was said and done.

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IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice, Rolls Building
Fetter Lane, London, EC4A 1NL

Date: Thursday 12th November 2015

Before :

Mr Justice Nugee

Between:

Sharp & Others	**Claimants**
and	
Blank & others	**Defendants**

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Alan Steinfeld QC & Stuart Adair (instructed by **Harcus Sinclair UK Limited**) for the **Claimants**
Helen Davies QC & Tony Singla (instructed by **Herbert Smith Freehills**) for the **Defendants**

Hearing dates: 21st, 22nd and 23rd October 2015

Judgment
As Approved by the Court

Mr Justice Nugee:

Introduction

1. This is the last in a series of judgments or rulings that I have given either orally or in writing in relation to the Defendants' application for summary judgment under CPR 24.2 and/or a strike out under CPR 3.4(2)(a) in relation to various parts of the Particulars of Claim. The background is well known to the parties and briefly summarised in my judgment on the LIBOR allegation and I need not repeat it. This judgment deals with a number of points of law raised by the Defendants as to the Claimants' pleading of fiduciary and tortious duties owed by the Defendant directors to the Claimants as shareholders in Lloyds.

The pleadings

2. The generic Particulars of Claim contain the following allegations under the heading "the Duties owed to the Shareholders of Lloyds"

> "37. The directors of Lloyds had had the benefit of detailed disclosure by the directors of HBOS and, through the teams carrying out due diligence, full access to the books and records of HBOS. In the premises, the knowledge of the directors of Lloyds of the financial circumstances of HBOS was vastly superior to the knowledge of the Lloyds shareholders. The Lloyds shareholders relied on the directors of Lloyds to provide them with information. The directors of Lloyds, including the Defendants, advised the shareholders of Lloyds that (a) Lloyds' acquisition of HBOS and (b) the recapitalisation of Lloyds through participation in the Recapitalisation Scheme were in their best interests and recommended that they approved both transactions. Further, the directors of Lloyds provided disclosure of information in various forms relating to the proposed transactions. In giving such advice, making such recommendations and providing disclosure of information the Defendants voluntarily undertook responsibility for:
>
> (1) The correctness of the advice and recommendations given to Lloyds shareholders;
>
> (2) The completeness and accuracy of all material information provided to the Lloyds shareholders in respect of the proposed transactions.
>
> 38. In advising the shareholders of Lloyds in relation to the merits of the acquisition of HBOS and recapitalisation, in providing information to the shareholders to enable them to make an informed decision as to whether or not to approve the acquisition of HBOS and the recapitalisation of Lloyds, in procuring and/or permitting the transactions to be put before the Lloyds shareholders for approval and in procuring the completion of the transactions the Defendants owed the shareholders of Lloyds (including, for the avoidance of doubt, the holders of Lloyds ADRs), including the Claimants, both fiduciary duties

and a common law duty of care in tort.

39. The fiduciary duties owed to the shareholders of Lloyds (including the Claimants) by the Defendants included, *inter alia*, the following duties ("the Fiduciary Duties"):

    (1) A duty to act in good faith;

    (2) A duty to act in the best interests of the Claimants and to prevent them from suffering loss;

    (3) A duty not to mislead the Claimants or conceal material information from them;

    (4) A duty not to place themselves in a position where their duties to the Claimants conflicted with their personal interests or their duties or obligations to any third party;

    (5) A duty to act for a proper purpose;

    (6) A duty to advise and inform the shareholders of Lloyds in clear, and readily comprehensible terms.

40. Further, the common law duty of care owed to the shareholders of Lloyds (including the Claimants) by the Defendants included, *inter alia*, the following duties ("the Tortious Duties"):

    (1) A duty to use reasonable care and skill when providing advice and information to the Claimants;

    (2) A duty to ensure that the information provided to the Claimants was complete and did not contain any material omissions;

    (3) A duty to ensure that any advice provided to the Claimants was reasoned and supported by the information available to the Defendants;

    (4) A duty not to mislead the Claimants or conceal information from them.

    (5) A duty to take all reasonable steps to prevent the claimants from suffering loss and damage."

3. So far as tortious duties are concerned it is admitted in the Defence (at paragraph 37(e)(1)) that the Defendant directors owed the shareholders a duty to take reasonable care and skill in insofar as they made any written statements and/or provided any recommendations in certain documents (the Announcement, Revised Announcement and Circular, which included the Chairman's Letter). It is not admitted that that extended to oral statements in the course of meetings and conference calls, but that is not a matter that has been argued before me.

4. Only one issue was raised by Ms Davies on this application in relation to the tortious duties pleaded and I will deal with that here. It concerned the plea in paragraph 40(5) of the Particulars of Claim that the tortious duties involved a duty to take all reasonable steps to prevent the Claimants from suffering loss and damage. It became apparent however in the course of argument that Mr Steinfeld did not attempt to support the duty pleaded in paragraph 40(5) as a free-standing head of duty. He said that it had really been meant to plead that the loss that had been suffered was within the scope of the tortious duties relied on, so as to satisfy the requirement in *South Australia Asset Management Corporation v York Montague Ltd* [1997] AC 191 that a claimant must not only show a breach of duty but that "it was a duty in respect of the kind of loss which he has suffered". If that is what it was attempting to do it was not a particularly informative or successful way of doing it as paragraph 40(5) did not identify any particular kind of loss at all; but I need not take up any time with this as Mr Steinfeld in effect accepted that it was not pleaded as tidily as it might have been. As I suggested in argument the effect that Mr Steinfeld said the plea was intended to achieve would be more accurately expressed by deleting paragraph 40(5) as it currently stands and adding instead at the end of paragraph 40 a plea that the scope of the tortious duties pleaded in paragraphs 40(1)-(4) above included a duty in respect of the kinds of losses which the claimants claim to have suffered as pleaded below, with a cross-reference to where the plea of loss and damage can be found. I did not understand Mr Steinfeld to dissent from that or Ms Davies to object in principle to an amendment along those lines. No formal application to amend to that effect was before me but the Claimants intend to tidy up their pleading in any event and I assume that this is one of the matters that will be addressed. In those circumstances I do not propose to say any more about that aspect of the application.

5. The remainder of this part of Ms Davies' application concerned the plea of fiduciary duties. The Defence admits at paragraph 37(f) that the Defendant directors owed a duty in equity in these terms:

> "It is admitted and averred that between the date of the Announcement and the date of the EGM the Director Defendants owed a duty in equity to the shareholders in Lloyds (including the Claimants) to provide them with sufficient information as to enable them to make an informed decision as to how to vote at the EGM in relation to Lloyds' acquisition of HBOS and its participation in the Recapitalisation Scheme."

I will call this the "sufficient information duty".

6. Although the application notice sought to strike out the whole of paragraph 39 where the Fiduciary Duties are pleaded out, in the light of the Defendants' acceptance that they owed the sufficient information duty, Ms Davies accepted that she could not really dispute the duties pleaded at paragraphs 39(3) (duty not to mislead or conceal material information) and 39(6) (duty to advise and inform the shareholders in clear and readily comprehensible terms); and although she said that the authorities suggested that the better description of the sufficient information duty was a "duty in equity" rather than a "fiduciary duty" she did not seek to argue which was correct, and was content to proceed on the basis that the duty was arguably a fiduciary one. I agree that what is important is the content of the duty, not the label put on it.

7. She did however object to the other duties pleaded. Her submission in summary was

that directors of a company do not in general owe fiduciary duties to the company's shareholders, and that there is nothing in the facts relied on here that warrants the conclusion that the directors owed any other equitable duty than the sufficient information duty.

8. I accept this submission and I will now try and explain why.

Fiduciary duties owed by directors

9. The general principles are well established:

(1) The directors of a company owe fiduciary duties to the company. This is unexceptionable and flows from the fact that the directors are agents of the company and stewards of its affairs. As Mummery LJ puts it in *Peskin v Anderson* [2001] 1 BCLC 372 at [33] the fiduciary duties owed by directors to the company "arise from the relationship between the directors and the company directed and controlled by them"; it is the fact that they are directors of the company's affairs which by itself gives rise to their fiduciary duties.

(2) But in general the directors do not, solely by virtue of their office of director, owe fiduciary duties to the shareholders, collectively or individually: *Peskin v Anderson* at [29]. As pointed out by Handley JA in the New South Wales Court of Appeal in *Brunninghausen v Glavanics* (1999) 32 ACSR 294 at [40], this is in essence no more than an application of the principle established by *Salomon v A Salomon & Co Ltd* [1897] AC 22 that a company is distinct from its members. The directors direct and control the affairs and assets of the company; they do not direct or control the affairs or assets of the members.

(3) The general principle that directors do not owe fiduciary duties to shareholders has also been said to be supported by a number of policy considerations. Handley JA in *Brunninghausen* referred to the fact that only the company, not its members, can sue for wrongs done to the company (under the rule in *Foss v Harbottle* (1843) 2 Hare 461), and the principle that where a wrong has been done to a company, individual shareholders are not able to sue for losses which are merely derivative or reflective (as exemplified by *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204 and *Stein v Blake* [1998] 1 AER 724) – this is of course not a complete explanation as some losses claimed by shareholders go beyond merely reflective loss (as indeed in the present case). Handley JA also said that if the directors owed fiduciary duties to the shareholders they would be liable to harassing actions by minority shareholders, and exposed to a multiplicity of actions, each shareholder having his own personal claim. This latter point was also made by Mummery LJ in *Peskin v Anderson* at [30] where he said that it was important that directors are not over-exposed to the risk of multiple legal actions by dissenting minority shareholders. At first instance in the same case Neuberger J said that to hold that a director owed some sort of general fiduciary duty to shareholders would involve placing an unfair, unrealistic and uncertain burden on a director, and would present him frequently with a position where his duty to shareholders would be in conflict with his undoubted duty to the company: [2000] 2 BCLC 1 at 14. The idea of a potential conflict between the directors' duty to the company and their

supposed duty to shareholders can also be found in *Perceval v Wright* [1902] 2 Ch 421, often regarded as the origin of this line of authority, where Swinfen Eady J referred to the fact that if directors owed a duty to disclose negotiations to shareholders it would place them in a most invidious position, as premature disclosure of negotiations might well be against the best interests of the company.

(4) The actual decision in *Perceval v Wright* has had a chequered history which it is not necessary to recount; whatever the merits of the actual decision, the general principle that directors do not owe fiduciary duties to their shareholders is confirmed by *Peskin v Anderson* and is not in doubt.

10. There are however circumstances where directors have been held to owe particular fiduciary duties to shareholders. The duties that arise in such cases are dependent on establishing a "special factual relationship" between the directors and the shareholders in the particular case: *Peskin v Anderson* per Mummery LJ at [33]. Examples put before me are as follows:

(1) *Allen v Hyatt* (1914) 30 TLR 444, a decision of the Privy Council in a Canadian appeal, where it was held that directors who had acquired shares from shareholders in order to sell them to a third party had made themselves agents for the shareholders, and hence were accountable for the profits they had made.

(2) *Coleman v Myers* [1977] 2 NZLR 225, a decision of the Court of Appeal of New Zealand, where the company was an old established private company in which many of the shareholders, individually or through trusts, were relatives, and two directors (father and son) engineered a takeover, persuading some members of the family to sell, and seeking to compel a reluctant minority. It was held that in the particular circumstances the directors owed fiduciary duties. Woodhouse J said (at 325) that in deciding the standard of conduct required from a director in relation to dealings with a shareholder it was not possible to lay down any general test, but some factors would usually be influential , including:

> "dependence upon information or advice, the existence of a relationship of confidence, the significance of some particular transaction for the parties and, of course, the extent of any positive action taken by or on behalf of the director or directors to promote it."

Cooke J thought it obvious that a fiduciary duty was owed in the particular circumstances of the case, summarising the facts which gave rise to the duty as being (at 330):

> "the positions of father and son in the company and the family; their high degree of inside knowledge; and the way they went about the take-over and the persuasion of shareholders."

Casey J (at 371) referred in particular to the fact that it must have been obvious to the son that other shareholders were reposing trust and confidence

in him; and that the father was in everyone's eyes the head of the family group and its associated shareholders:

> "whom they respected to look after their personal interests in the management of the company."

(3) *re Chez Nico (Restaurants) Ltd* [1992] BCLC 192, where Sir Nicolas Browne-Wilkinson V-C referred to *Coleman v Myers* and said (at 208):

> "Like the Court of Appeal in New Zealand, I consider the law to be that in general directors do not owe fiduciary duties to shareholders but owe them to the company; however in certain special circumstances fiduciary duties, carrying with them a duty of disclosure, can arise which place directors in a fiduciary capacity vis-à-vis the shareholders. *Coleman v Myers* itself shows that where directors are purchasing shares in the company from outside shareholders such duty of disclosure may arise dependent on the circumstances of the case."

On the facts of the case he did not in fact have to decide whether such a duty arose or not.

(4) *Platt v Platt* [1999] 2 BCLC 745, a decision of David Mackie QC, sitting as a Judge of the High Court. He held, following *Coleman v Myers* and the *obiter* comments in *re Chez Nico*, that a fiduciary duty was owed where the oldest of 3 brothers, who was the only director of the company, bought out his younger brothers who held preference shares. The Court of Appeal dismissed an appeal without expressing any views on this particular point.

(5) I was not referred to any other English case where such a fiduciary duty had been held to arise, although there are a number of other cases from overseas. It is not necessary to refer to them in any detail: see *Dusik v Newton* (1985) 62 BCLR 1 (where the Court of Appeal of British Columbia held that a special relationship existed between a director and the only other shareholder); *Brunninghausen* (also concerning a company with only two shareholders, where the sole director bought out the other shareholder); *Crawley v Short* [2009] NSWCA 410 (where one of three shareholders was bought out); and *Valastiak v Valastiak* [2010] BCCA 71 (misappropriation by director of company property held to be a breach of fiduciary duty to his wife who was the beneficial owner of half the shares). All these cases concerned small closely-held companies.

11. By contrast in *Peskin v Anderson* both Neuberger J and the Court of Appeal held that directors of the Royal Automobile Club Ltd who were contemplating a sale of the company's motoring services business did not owe a fiduciary duty to members who had resigned, or not renewed, their membership in ignorance of the proposals and who had thus missed out on substantial payments made to those who were members when the transactions completed. Mummery LJ said (at [59]) that there was "nothing special" in the factual relationship between the directors and the members, and no relevant dealings or negotiations between them.

12. I take it therefore to be established law, binding on me, that although a director of a company can owe fiduciary duties to the company's shareholders, he does not do so by the mere fact of being a director, but only where there is on the facts of the particular case a "special relationship" between the director and the shareholders. It seems to me to follow that this special relationship must be something over and above the usual relationship that any director of a company has with its shareholders. It is not enough that the director, as a director, has more knowledge of the company's affairs than the shareholders have: since they direct and control the company's affairs this will almost inevitably be the case. Nor is it enough that the actions of the directors will have the potential to affect the shareholders – again this will always, or almost always, be the case. On the decided cases the sort of relationship that has given rise to a fiduciary duty has been where there has been some personal relationship or particular dealing or transaction between them.

13. I do not find this surprising. A fiduciary, as explained by Millett LJ in his classic judgment in *Bristol & West Building Society v Mothew* [1998] Ch 1 at 18A-F, is someone who has undertaken to act for or on behalf of another in circumstances which give rise to a relationship of trust and confidence. That is why the distinguishing obligation of a fiduciary is the obligation of loyalty: someone who has agreed to act in the interests of another has to put the interests of that other first. But the relationship between directors and shareholders is not in general like that. A director is a fiduciary for his company: by agreeing to act as director, he necessarily agrees to act in the interests of the company. But he does not have, by virtue of his appointment as director, any direct relationship with the shareholders: no doubt the interests of the shareholders and the company are in general aligned but this does not mean that a director has agreed to act for the individual shareholders or has a direct relationship with them – his relationship is with the company. If he is to be held to owe fiduciary duties to the individual shareholders, there must be something unusual in the nature of the relationship which gives rise to it. That no doubt explains why the cases where such a duty has been held to exist mostly concern companies which are small and closely held, where there is often a family or other personal relationship between the parties, and where, in almost all cases, there is a particular transaction involved in which directors are dealing with the shareholders, from which the directors often stand to benefit personally. The imposition of a fiduciary duty in such circumstances reflects the fact that directors who have a close family or other personal relationship with shareholders, and are entering into transactions with them, may be tempted to exploit that relationship to take unfair advantage of the shareholders for their own benefit.

Application of principles

14. The present case is a long way removed from that paradigm case. It is therefore necessary to consider what is said by the Claimants to give rise to fiduciary duties nevertheless being owed. That is found in paragraph 37 of the Particulars of Claim. What is there said is effectively (i) that the directors had vastly superior knowledge to the shareholders and (ii) that the shareholders relied on the directors to provide them with information. To this is added the plea that in giving advice, making recommendations and providing information, the Defendants "voluntarily undertook responsibility" for the correctness of advice and recommendations and the completeness and accuracy of information. The language of voluntary undertaking of

responsibility suggests that what the pleader had in mind was the well-known line of authority that the voluntary assumption of responsibility can be a factor in deciding whether a tortious duty of care is owed, and this part of the plea reads as if it is directed primarily at establishing a tortious duty. I will assume however that it is also directed at establishing fiduciary duties.

15. But even on this basis the facts relied on do not seem to me to plead any special relationship between directors and shareholders such as the authorities require. All that the pleaded facts really amount to is that the directors, who knew more about the company than the shareholders (the addition of "vastly" does not seem to me to change the analysis), were giving the shareholders advice and information to enable them to decide how to vote at the forthcoming EGM. That is the only relationship pleaded. It is not disputed that such a relationship – that is the relationship between directors who invite shareholders to vote at an EGM and give them advice and information in that connection, and the shareholders – does give rise to a duty, namely the sufficient information duty, which is expressly accepted to include a duty not to mislead or conceal material information, and a duty to give advice and information in clear and readily comprehensible terms. But once this duty is accepted, what other duty do these facts give rise to ? In my judgment there is none. The relationship is one of giving advice and information for a particular purpose: there is nothing here which as far as I can see comes close to a relationship where the directors have in any more extended sense undertaken to act for or on behalf of the shareholders in such a way as to give rise to a duty of loyalty, or have undertaken an obligation to put the interests of shareholders first, or are themselves entering into transactions with the shareholders, or where there are any of the other hallmarks of a fiduciary relationship.

16. In my judgment the facts pleaded in paragraph 37 of the Particulars of Claim do not amount to a special relationship which give rise to any fiduciary duties being owed by the directors to the shareholders beyond the sufficient information duty.

Mr Steinfeld's argument

17. Mr Steinfeld's argument did not really dispute the principles to be derived from the English and overseas authorities. His position was the simple one that once it was accepted that there was a fiduciary duty, the other duties pleaded in paragraph 39 were all part of that duty as they were inherent in any fiduciary duty. He referred to the exposition in *Mothew's* case of what the distinguishing duty of loyalty means: this includes acting in good faith and not putting oneself in a position of conflict.

18. This seems to me to fall into the error of starting by labelling a particular duty as a fiduciary duty and then using that label to determine what the content of the duty is. This is the wrong way round. One should first identify what the content of the duty owed by a person in particular factual circumstances is; it is then possible to characterise that duty as being fiduciary or not – and indeed to characterise the person as a fiduciary or not. As Millett LJ said in *Mothew* (at 18C):

> "As Dr. Finn pointed out in his classic work *Fiduciary Obligations* (1977), p.2, he is not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to them that he is a fiduciary."

19. It seems to me therefore that rather than starting with whether the sufficient

information duty is a fiduciary duty and arguing for its content from that, the correct starting point is to identify what the content of the sufficient information duty is. This can be found conveniently set out in the judgment of Neuberger J in *re RAC Motoring Services Ltd* [2000] 1 BCLC 307, an earlier round of litigation arising out of the disposal by the RAC of its motoring services business. At 327a-c, he cites from the Australian decision of *Residues Treatment & Trading Co Ltd v Southern Resources Ltd* (1988) 14 ACLR 375 at 377-8 where White J said:

> "The directors have a duty in equity to give to shareholders sufficient information for them to make informed decisions about proposals to be put them at meetings."

and

> "The essence of the duty is reasonableness or fairness in the circumstances having regard to the interests of the company as a whole."

20. White J referred in that case to the duty being of long standing, and Neuberger J himself cites at 326a-i from two cases from the end of the 19th century, *Kaye v Croydon Tramways Co* [1898] 1 Ch 358, and *Tiessen v Henderson* [1899] 1 Ch 861. Both cases characterise the rule as a rule of ordinary fairness: in the former case Sir Nathaniel Lindley MR refers to "ordinary fairness of language" and Rigby LJ to the purpose of the meeting being "fairly and in language that could be understood by ordinary people disclosed"; and in the latter case Kekewich J refers to the shareholder having "fair warning of what was to be submitted to the meeting."

21. I do not find in these citations – or in anything else that I was shown – any suggestion that the sufficient information duty shares the characteristics typical of fiduciary duties owed by those who have undertaken to act in the interests of others and who have agreed to serve the interests of others with loyalty. The wellspring of this duty is not that the directors have agreed to put the interests of the shareholders first, but the much more simple one that if they are going to invite the shareholders to a meeting, common fairness requires that they explain what the purpose of the meeting is. That includes being clear and comprehensible and not misleading or tricky; but the reason for this is one of fairness, not of loyalty.

22. In these circumstances I am very doubtful if it is appropriate to describe this duty as a fiduciary duty at all, but whether or not that is so (and as I have already said Ms Davies accepted that this was arguable), it does not seem to me that the duty includes all the usual attributes of fiduciary duties as set out in *Mothew's* case.

23. Specifically as to the duties pleaded in paragraph 39:

    (1) Paragraph 39(1) pleads a duty to act in good faith. The expression "good faith" is unfortunately an ambiguous one. In most cases to accuse someone of a breach of a duty of good faith is to accuse them of acting in bad faith, which itself connotes acting with some conscious improper motive. In the present case the Claimants did initially plead that the Defendants in some respects acted in bad faith, but they do not wish to pursue those allegations and have agreed that they will amend to delete them (although as appears below at least one seems to have survived, in paragraph 121(5), I assume inadvertently). In

those circumstances "good faith" in this sense is not in issue. In some contexts however, including that of fiduciary duties, the context of "good faith" is used as a shorthand for certain duties, including in particular the duty of a fiduciary to disclose material facts before entering into a transaction with his principal, and it is possible to breach a duty such as that without conscious or deliberate impropriety. As Mr Steinfeld made clear, it is that extended sense of "good faith" which the Claimants seek to invoke here, but for the reasons I have sought to give, that type of good faith obligation does not in my judgment form part of the sufficient information duty.

(2) Paragraph 39(2) pleads a duty to act in the best interests of the Claimants and to prevent them from suffering loss. That duty cannot in my judgment be derived from the sufficient information duty.

Ms Davies also objected to this duty on the basis that fiduciary duties are always proscriptive not prescriptive, citing *Breen v Williams* [1997] 1 LRC 2121 at 250-1 and *Pilmer v Duke Group Ltd (in liquidation)* [2001] 2 BCLC 773 at [69]-[83], both decisions of the High Court of Australia. I do not intend to embark on a discussion of this point, which seems to me to raise quite difficult issues – for example express trustees (who are certainly fiduciaries) are in some respects under a positive duty to act in the best interests of their beneficiaries, and one would have thought this was an example of a prescriptive fiduciary duty; it is sufficient to say, as I have, that whatever the scope of the sufficient information duty it does not extend to a positive duty to act in the best interests of the shareholders or prevent them from suffering loss.

(3) Paragraph 39(3) pleads a duty not to mislead the Claimants or conceal material information from them and is not disputed.

(4) Paragraph 39(4) pleads a duty not to place themselves in a position of conflict. Again I do not think this can be derived from the sufficient information duty.

Without finally deciding anything at this stage, I may add that it is not clear to me that this conclusion has any practical significance. I was referred to paragraph 120(4) where it is pleaded that the Defendant directors put themselves in a position of conflict between their duties to the shareholders not to conceal information from them and the interests of third parties such as the UK government and others in maintaining secrecy in various matters. I do not see that this adds anything of substance to the allegation that the directors did not disclose what they should have done. Either the sufficient information duty required them to disclose something more to shareholders or it did not. If it did, then they were in breach of duty and it does not I think matter what their reasons were for failing to disclose. If it did not, the question falls away and the reason why they did not disclose is equally irrelevant.

(5) Paragraph 39(5) pleads a duty to act for a proper purpose. It is trite law that any powers (whether fiduciary or not) can be exercised only for the purposes for which they are conferred, and not for any extraneous or ulterior purpose, and this is certainly true of the powers conferred on directors. But the duty of directors to use their powers for a proper purpose is a facet of the duties owed

by directors to their company. (This has now in fact been put on a statutory footing: see s. 170(1), s. 171(b) of the Companies Act 2006). I do not see that this is a duty separately owed to the shareholders; nor do I see it as encompassed within the sufficient information duty.

(6) Paragraph 39(6) pleads a duty to advise and inform the Lloyds shareholders in clear and readily comprehensible terms, and is not disputed.

Save for the duties pleaded at paragraphs 39(3) and (6) therefore, the other duties pleaded in paragraph 39 do not in my judgment form part of the sufficient information duty, and on the facts pleaded in paragraph 37 are not sustainable in law. I will therefore strike them out under CPR 3.4(2)(a) on the basis that they disclose no reasonable grounds for bringing the claim (CPR 3.4(2)(a) refers to striking out a statement of case but by CPR 3.4(1) this includes part of a statement of case).

Calling of the EGM

24. Ms Davies also sought to attack one other aspect of the Particulars of Claim, namely paragraphs 121, 122(2) and 127. These read as follows:

(1) Paragraph 121:

"In the light of the Directors' Knowledge, the Written and Oral Representations, the Omissions and, in particular, the Concealment, it was a breach of the Fiduciary Duties and/or Tortious Duties for the directors of Lloyds, including the Defendants, to (a) put the proposed acquisition of HBOS and participation in the Recapitalisation Scheme to shareholders and/or (b) permit the EGM to take place and the Lloyds shareholders to vote on the Resolutions on the basis of what they knew to be incomplete and misleading information, statements and advice."

This is followed by Particulars of Breaches. Sub-paragraphs (1) to (4) of these plead certain things that the Defendant directors are said to have known. It continues

"(5) In the premises, in putting the proposed transactions to shareholders and/or permitting the EGM to take place and Lloyds shareholders to vote on the Resolutions, the Defendants were acting in bad faith and contrary to the best interest of shareholders.

(6) Alternatively, if it be alleged that the Defendants did not know or understand any of the matters detailed at subparagraphs (1) to (4) above, the Defendants ought to have known and understood those matters and, therefore, acted negligently in permitting the EGM to have taken place."

(2) Paragraph 122:

"In the premises set out above, the Defendants, acting in accordance with the Fiduciary Duties and/or the Tortious Duties rather than breaching them, would have either

(1) Disclosed to Lloyds shareholders the fact that HBOS had received a £10 billion loan from Lloyds and was wholly reliant on covert financial support from the Bank of England and the Federal Reserve to enable it to pay its debts as they fell due and to continue to trade; or

(2) Declined to proceed with the acquisition of HBOS."

(3) Paragraph 127:

"In breach of the Fiduciary Duties and/or the Tortious Duties, the directors of Lloyds, including the Defendants, procured that the EGM took place on 19th November 2006 in accordance with the Notice."

25. Ms Davies' submission is that the allegation that it was a breach of duty to go ahead with the EGM must on analysis be based on the supposed duties to prevent loss to the shareholders, as the other duties all relate to the provision of information and advice to shareholders. It became clear in the course of argument that her particular concern was that an allegation that it was a breach of duty to permit the EGM to go ahead would enable the Claimants to run the argument on causation that (i) the Defendants were in breach of duty in allowing the EGM to proceed; (ii) if the Defendants had not been in breach of duty the EGM would not have taken place; (iii) if the EGM had not taken place the acquisition of HBOS would not have happened; and therefore (iv) damages (or equitable compensation) should be assessed on the basis of the position the Claimants would have been in had the acquisition not gone ahead.

26. This is not I think an argument that is open to the Claimants on the current pleadings. The allegation that the Defendants' various breaches of duty caused the Claimants loss is found firstly in paragraphs 122 to 125. Paragraph 122 (set out above) does not simply plead that the Defendants would not have gone ahead with the EGM had they complied with their duties: as can be seen, it pleads that the Defendants would *either* have disclosed certain matters *or* not gone ahead. In principle I can see nothing illogical or wrong in such a plea. It is accepted that the duty of directors when calling an EGM is or includes the sufficient information duty. Suppose that the Court holds that this duty required the disclosure of a particular fact. It follows that for the directors to go ahead with the EGM without disclosure of that fact was a breach of duty. It seems to me true and unobjectionable to say that in those circumstances if the directors were to avoid being in breach of duty they either had to disclose the fact or not proceed with the EGM. To put it another way the formulation of the sufficient information duty by White J in the *Residues Treatment* case (adopted by Neuberger J in *re RAC Motoring Services Ltd*) is a duty to give shareholders:

"sufficient information for them to make informed decisions about proposals to be put them at meetings."

It follows that if no proposals are put, no information needs to be provided, so directors can avoid being in breach either by not putting proposals or by providing the requisite information. I am not therefore persuaded that paragraph 122(2) or any part of paragraph 122 falls to be struck out.

27. What however this does not do is answer the question how one assesses the loss

caused by the breach. That depends on what would have happened had the directors not acted in breach of duty. Paragraph 123 pleads that if the matters referred to in paragraph 122(1) had been disclosed this would have been picked up by the financial press and market analysts and they would have written extensively on the folly of Lloyds' acquisition of HBOS on the proposed terms, and Lloyds would have been forced to pull out of the acquisition; paragraph 124 then pleads an alternative case that no shareholder properly informed of the true financial circumstances of HBOS would have voted in favour of the acquisition. Paragraph 125 then pleads that it necessarily follows that if the Defendants had acted in accordance with their duties, the acquisition would not have gone ahead and the Claimants would not have suffered the loss and damage for which the claim is made.

28. None of this seems to me to assert that the Claimants can establish causation on the simple basis that it was a breach of duty to call the EGM and hence that loss should be assessed by reference to what would have happened had the EGM not been called. On the contrary, it seems to me plain that to make good the plea at paragraph 125 that the Claimants would not have suffered the loss claimed, the Claimants will have to establish not only a breach of duty, but also that if there had been disclosure either the acquisition would not have gone ahead for the reasons pleaded in paragraph 123 (the directors being forced to pull out of the acquisition as a result of press and market commentary on the folly of proceeding), or for the reasons pleaded in paragraph 124 (the shareholders not voting in favour of it). As I understood it, Mr Steinfeld accepted that in the course of argument, but whether he did or not, I am clearly of the view that the current pleading does require the Claimants to establish causation by establishing what would have happened had the directors made the disclosure which they say should have been made.

29. There is a further plea of causation in paragraphs 130 to 133: paragraph 130 pleads that the Lloyds shareholders relied on various representations and other matters; paragraph 131 that they were misled as to the true merits by various representations and omissions; paragraph 132 that if they had not been misled:

> "the majority in number and by value of the Lloyds shareholders would have voted against the Resolutions at the EGM on 19th November 2008 and would not have suffered the loss and damage in respect of which this claim is made"

and paragraph 133 then adds that although some of the Claimants in fact voted against the Resolutions or abstained they too have suffered loss because the Defendant directors misled the vast majority of shareholders into voting in favour of them.

30. As can be seen there is no suggestion in those paragraphs either that the Claimants can establish causation on the basis that it was a breach of duty to call the EGM and hence that loss should be assessed by reference to what would have happened had the EGM not been called. It is firmly tied to the question how the majority of shareholders would have voted had they not been misled by the alleged misrepresentations and omissions which are said to constitute a breach of duty.

31. In these circumstances Ms Davies' concerns about this point largely I think fall away. But taking the 3 paragraphs that are attacked on their merits, my views are as follows:

(1) I have already said that there seems to me nothing wrong with paragraph 122.

(2) Paragraphs 121 and 127 can be taken together. Although paragraph 127 taken by itself appears to plead simply that it was a breach of duty to hold the EGM, Mr Steinfeld accepted that this was not intended to go beyond what was alleged in paragraph 121 and should be read as a reference back to what was said there.

(3) Paragraph 121 alleges a breach of both fiduciary and tortious duties (as does paragraph 127). So far as tortious duties are concerned, this has to be read with paragraph 121(6) which pleads that it was negligent of the Defendants to permit the EGM to take place when they ought to have known certain matters. I agree with Ms Davies that this can only be understood as a breach of the particular duty pleaded at paragraph 40(5), as the other tortious duties are all concerned with a duty to take care in giving advice and I do not see how it can be a breach of a duty to take care in giving advice not to hold the EGM. But with the clarification that paragraph 40(5) is not intended to plead a freestanding duty and is only intended to plead that the scope of the duty of care extended to the losses claimed, it can be seen that there is no duty which will support this particular allegation of negligence. It does seem to me therefore that Ms Davies is right that the references to tortious duties in paragraphs 121 and 127 are unsustainable and should be struck out.

(4) That leaves the allegation of breach of fiduciary duties. As I read it (and Mr Steinfeld did not suggest to the contrary) the words at the end ("on the basis of what they knew to be incomplete and misleading information, statements and advice") are intended to qualify both limb (a) (putting the proposed acquisition to shareholders) and limb (b) (permitting the EGM to take place) as no sensible distinction can be drawn between them. On this assumption the statement in the body of the paragraph that it was a breach of duty to allow the EGM to go ahead without full information seems to me merely another way of saying that their duty was to provide sufficient information if the matter was to go ahead. I do not think that by itself it is objectionable.

(5) However the particulars of breach given under this paragraph, which are found in sub-paragraph (5), refer to the directors acting in bad faith and contrary to the best interests of Lloyds shareholders. These are clearly pleaded as breaches of the duties in paragraphs 39(1) and (2) which I have already held to be unsustainable. Since this is the only basis for the plea of breach of fiduciary duties in paragraph 121, I think it logically follows that the plea of breach of fiduciary duties is unsustainable.

(6) Since I have held that neither the plea of breach of tortious duties nor the plea of breach of fiduciary duties is sustainable, I consider that this paragraph (and paragraph 127 which is dependent on it) do also fall to be struck out pursuant to CPR 3.4(2)(a).

Conclusion

32. It may be helpful if I summarise my conclusions:

(1) Paragraph 40(5), which is not intended to plead a separate free-standing tortious duty, should be deleted and replaced by a statement that the duties in paragraph 40(1)-(4) included duties in respect of the kinds of losses which the claimants claim to have suffered.

(2) Paragraphs 39(3) and 39(6) are not objected to but paragraphs 39(1), (2), (4) and (5) should be struck out.

(3) Paragraph 122, including paragraph 122(2), is not objectionable and should be allowed to stand.

(4) Paragraphs 121 and 127 should be struck out.

33. Where I have held that parts of the pleading should be struck out, I have done so under the powers in CPR 3.4(2)(a). The application notice relies in the alternative on CPR 24.2 but in circumstances where I have held that the pleas do not plead a sustainable case in law, the powers in CPR 3.4 seems to me to be both adequate and fitting and I do not think that in those circumstances it is either necessary or appropriate to resort to the powers in CPR 24.2 as well.

IN THE GRAND COURT OF THE CAYMAN ISLANDS

CAUSE NO. G 224 OF 2015

BETWEEN:

(1) WILLIAM RITTER

(2) GENEVA INSURANCE SPC LIMITED (IN VOLUNTARY LIQUIDATION)

Plaintiffs

AND

BUTTERFIELD BANK (CAYMAN) LIMITED

Defendant

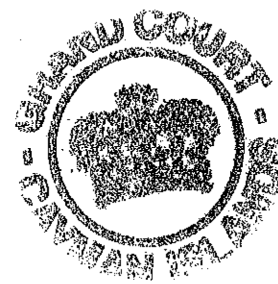
Appearances: Ms. Sarah Dobbyn of Sinclairs for the Plaintiffs
Mr. Sebastian Said & Ms. Jane Hale of Appleby for the Defendant

Heard: 20-22 February 2017, 8 March 2017, 26-29 September 2017

Written submissions: 14 November 2017

Draft Judgment circulated: 18 May 2018

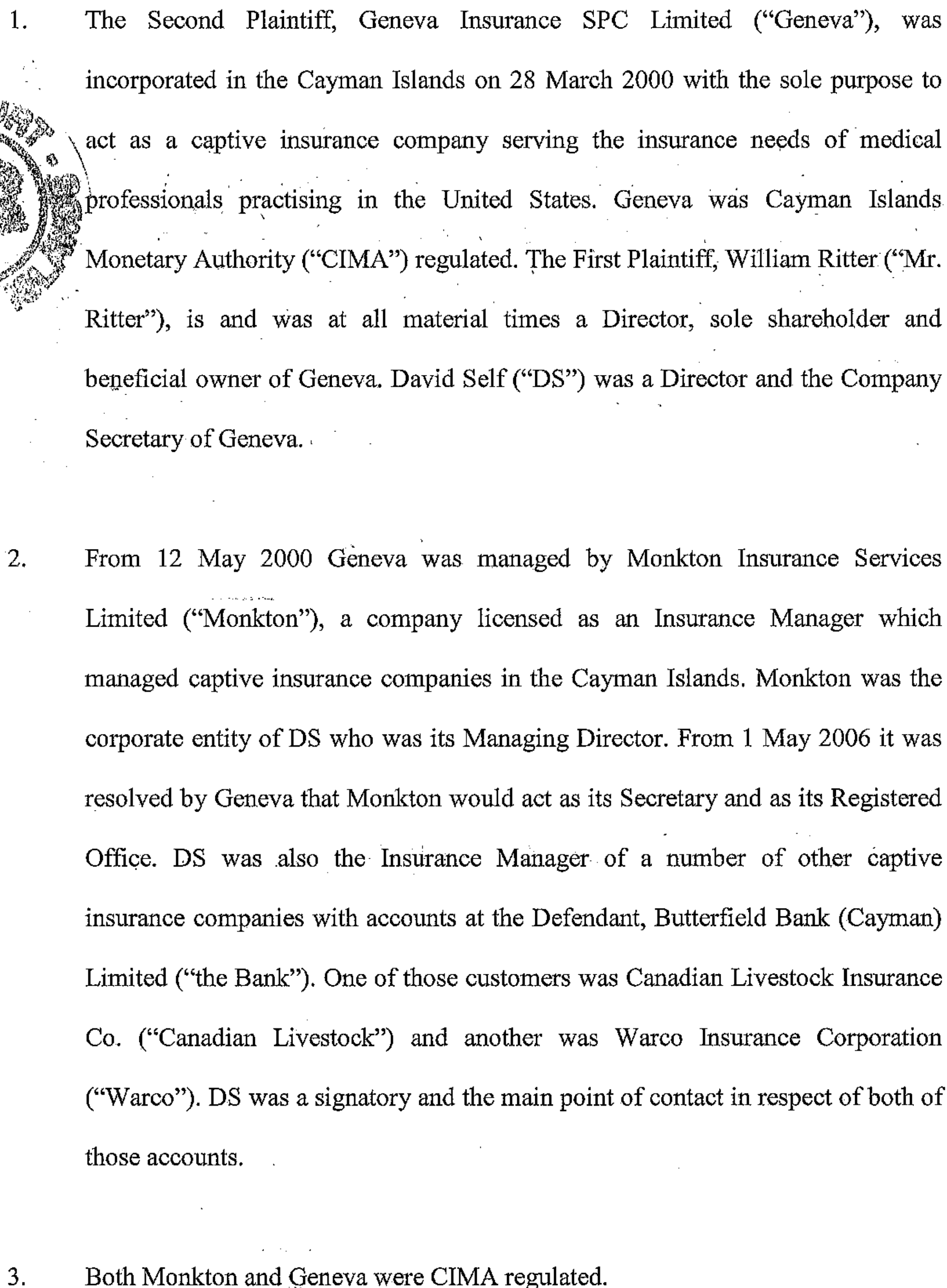
Final Judgment delivered: 29 May 2018



JUDGMENT

HEADNOTE

Bank - customer- forged signature on transactions - payment by bank - action to recover money paid - customer's knowledge of forgery – estoppel - duty of disclosure - delay in informing the bank of forgery - representation - detriment and loss of remedy against forger - dishonest assistance - dishonesty



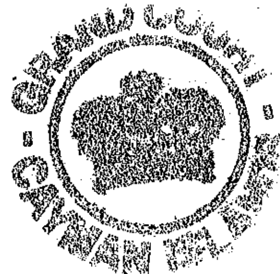
The Application

1. The Second Plaintiff, Geneva Insurance SPC Limited ("Geneva"), was incorporated in the Cayman Islands on 28 March 2000 with the sole purpose to act as a captive insurance company serving the insurance needs of medical professionals practising in the United States. Geneva was Cayman Islands Monetary Authority ("CIMA") regulated. The First Plaintiff, William Ritter ("Mr. Ritter"), is and was at all material times a Director, sole shareholder and beneficial owner of Geneva. David Self ("DS") was a Director and the Company Secretary of Geneva.

2. From 12 May 2000 Geneva was managed by Monkton Insurance Services Limited ("Monkton"), a company licensed as an Insurance Manager which managed captive insurance companies in the Cayman Islands. Monkton was the corporate entity of DS who was its Managing Director. From 1 May 2006 it was resolved by Geneva that Monkton would act as its Secretary and as its Registered Office. DS was also the Insurance Manager of a number of other captive insurance companies with accounts at the Defendant, Butterfield Bank (Cayman) Limited ("the Bank"). One of those customers was Canadian Livestock Insurance Co. ("Canadian Livestock") and another was Warco Insurance Corporation ("Warco"). DS was a signatory and the main point of contact in respect of both of those accounts.

3. Both Monkton and Geneva were CIMA regulated.

4. On 20 March 2008 Geneva opened a corporate bank account ("the Geneva Account") with the Bank. The Bank was incorporated in the Cayman Islands on 22 November 1967, and holds a Class A banking licence registered with CIMA. The Bank provided banking services to Geneva between 2008 and 2011. Geneva remained a customer with the Bank until the Geneva Account was closed in October 2013.

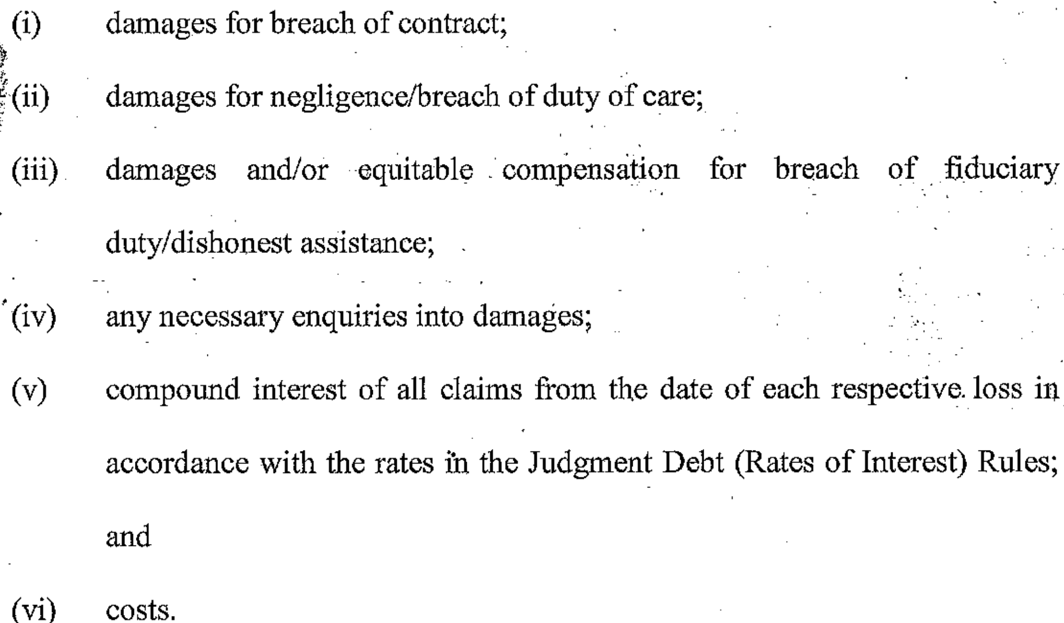


5. It is common ground that there were nine fraudulent transactions made by DS on the Geneva Account between 28 December 2008 and 13 September 2010. These included eight forged payment transfer requests from the Geneva Account and one fraudulent request for a payment from another account into the Geneva Account. These payments were honoured by the Bank and the Geneva Account was debited for a total of US$725,177.02. DS also defrauded the bank accounts of other Monkton clients at the Bank.

6. Due to the fraudulent transactions, on 30 April 2012 a shareholder's resolution was passed for the voluntary liquidation of Geneva. By a Deed of Assignment dated 7 November 2012, Geneva acting through the appointed Joint Voluntary Liquidators assigned all its potential rights, remedies and claims against the Bank to Mr. Ritter. On 27 February 2015 Mr. Ritter was appointed as the sole voluntary liquidator of Geneva.

The Claim

7. The Plaintiffs' claim is brought by a 54 page Amended Writ of Summons and Statement of Claim filed on 2 November 2016. The allegation therein is that the Bank is liable for breach of contract, negligence and dishonest assistance in facilitating a fraud carried out by DS. The Plaintiffs' claim:



(i) damages for breach of contract;

(ii) damages for negligence/breach of duty of care;

(iii) damages and/or equitable compensation for breach of fiduciary duty/dishonest assistance;

(iv) any necessary enquiries into damages;

(v) compound interest of all claims from the date of each respective loss in accordance with the rates in the Judgment Debt (Rates of Interest) Rules; and

(vi) costs.

8. DS provided false bank statements for the Geneva Account to Mr. Ritter to conceal the fraud mentioned in paragraph 5 above and outlined in greater detail from paragraph 31 herein. The Plaintiffs contend that the Bank, by allowing the withdrawals of money from the Geneva Account based on forged signatures, is in breach of their mandate and that their resultant net loss (excluding lost interest) from the Geneva Account is US$529,191.72.[1] The Plaintiffs seek an order for reimbursement of that amount together with interest and costs.

[1] Net balance after DS caused the fraudulent transfers to be repaid, US$148,180.74 on 23 June 2009 and US$$47,804.56 on 25 August 2011.

9. In its Amended Defence filed on 8 November 2016, the Bank denies any liability, contending that it provided banking services to Geneva on its standard terms and thereafter conducted itself in accordance with those terms and with good banking practice. It contends that Geneva failed to comply with its duties as the Bank's customer, because when Mr. Ritter became aware of the forgery on the Geneva Account on 1 September 2011 he failed to inform the Bank of the same until 27 August 2012. It is further contended that this deprived the Bank of the opportunity to properly act to prevent a number of other transactions and to enable it to take steps towards recovering money wrongfully paid on the forged signatures. In such circumstances, the Bank argues that Geneva is estopped from asserting the forgeries upon which its claim is based.

10. The Bank submits that the main issues for the Court to determine are:

(a) The date on which the Bank received notice of DS's forgery on the Geneva Account - The Bank claims this was on 27 August 2012 when the Joint Official Liquidators ("JOLs") for Geneva informed them that Mr. Ritter was challenging payments on the Geneva Account.

(b) Whether Mr. Ritter discharged a duty to disclose DS's forgery on the Geneva Account to the Bank - The Bank claims that Mr. Ritter failed to discharge his duty on 1 September 2011 immediately after he became aware that DS had forged his signature.

(c) If the Court finds that Mr. Ritter had not discharged his duty to disclose the fraud, whether his silence amounts to a representation - The Bank

submits that Mr. Ritter deliberately failed to inform the Bank of the forgery as he had a strategy to focus on the return of his money via a private arrangement with DS and that he intended to notify the Bank only if the money was not repaid by DS.

(d) If the Court finds that there has been conduct amounting to a representation, whether the Bank has suffered material detriment – The Bank claims that it has suffered detriment in the form of material prejudice as it has lost the opportunity to seek recovery from DS, due to it paying out large sums on 2 September 2011 and incurring significant legal fees in proceedings in both Texas and in the Cayman Islands.

(e) Whether the Bank dishonestly assisted in DS's fraud – The Bank denies that it or any of employees have acted dishonestly in the operation of the Geneva Account.

11. The Bank seeks an order from the Court dismissing the Plaintiffs' dishonesty claim, which is based on the same factual allegations relied upon by them for breach of contract and negligence, on the basis that there is a lack of evidence to justify such serious findings. It is also submitted that the claim is "*defectively pleaded*", the Bank stating that the Plaintiffs have failed to identify any employee(s) at the Bank who they claim has acted dishonestly. The Bank highlights that Mr. Ritter made no allegation of dishonesty against the Bank in the Texas proceedings.

12. The Plaintiffs argue that the Court should dismiss the Bank's estoppel defence and should also find in their favour in relation to the claim that the Bank was liable to account as a constructive trustee for dishonest assistance.

13. It is agreed that if the Bank's estoppel defence succeeds, the Plaintiffs' breach of contract and negligence claims should be dismissed. The Bank agrees that if its estoppel defence fails, it will pay to the Plaintiffs (without admission of liability) the full amount of the fraudulent transfers claimed.

14. It is agreed by the parties that the question of consequential losses would be determined at a later date depending on the ruling of the Court on the main estoppel defence and the claim for dishonest assistance.

The Background – Geneva Opening the Account at the Bank

15. In 2008, following representations made to him by DS, Mr. Ritter agreed that Geneva's banking should be moved to the Bank. To enable the Geneva Account to be opened, six main Account Opening Documents had to be processed and these documents governed the bank/customer relationship and constituted the Bank's mandate.

16. The First Account Opening Document is an undated and unsigned Corporate Banking: Captive Insurance Company – Account Opening Checklist ("the

Checklist")[2]. It was recorded in this form that the purpose of the Geneva Account was "*for core cell operating funds.*" The form also recorded that the nature of the anticipated transactions through the Geneva Account were "*cell fees and charges paid in quarterly, operating expenses, licence fee, audit admin, fee paid out.*" It is submitted by the Plaintiffs that it was an express term that the Geneva Account would be used only for the above purpose and that it was an implied term that payments other than those listed would be out of the ordinary course of business transactions. The Bank denies this contention, pointing out that the purpose of the checklist is to act as a general guide to the Bank as to the nature and dollar volume of the anticipated transactions through the account to enable it to comply with its obligations under the Proceeds of Crime Law and Money Laundering Regulations.

17. The Second Account Opening Document is the New Account Memorandum-Business ("the Memorandum") and it was filled out by DS and signed by Mr. Ritter as an authorised signatory on 20 March 2008.[3] The Court has not been shown any similar Memorandum signed by DS as an authorised signatory. The Plaintiffs contend that it was an express implied term of the Memorandum that the authorised signature of Mr. Ritter would be identical or closely resemble those entered on documents for the purposes of the Geneva Account at the Bank. The Bank denies the above contention and correctly states that the signature on the Memorandum is not the signature that would be used or should be used for

[2] Documents Bundle Volume 1 - Tab 11.
[3] Documents Bundle Volume 1 - Tab 12.

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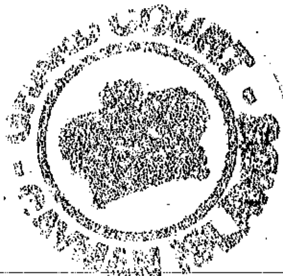
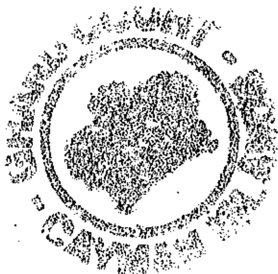
comparison with any subsequent signature received by the Bank on other documentation and that the appropriate comparison signature would be found on the Signature Card. The Memorandum provided only Monkton's and DS's numbers as the points of contact and therefore if there were any issues relating to a transaction DS, and not Mr. Ritter, would be the person who the Bank would reach out to.



18. The Third Account Opening Document is a Resolution Authorising Banking Account, Loans and Related Matters ("the Resolution")[4] which was filled out by DS. It was signed by DS on 20 March 2008 in his role as a Director and as the Secretary of Geneva. This document was also signed by Mr. Ritter as a Director of Geneva. DS and Mr. Ritter placed their initials on each page of the document. The document sets out the details of the resolution accepted by the Board of Directors held at a meeting on 20 March 2008. The Board of Directors resolved that Geneva was authorised to establish an account or accounts with the Bank for the purposes of buying, selling, paying or collecting bills of exchange or other instruments for the payments of money, issuing letters of credit, transmitting monies by draft cheques or wire transfer, or otherwise borrowing money for which the assets of Geneva may be pledged as collateral security and for any incidental purpose. The document recorded that the Board resolved that DS and Mr. Ritter, as long as they signed together, were authorised on behalf of Geneva to conduct affairs with the Bank in matters such as opening a bank account or accounts with the Bank, endorsing cheques, drafts, note acceptances and other

[4] Documents Bundle Volume 1 - Tab 13.



instruments and to make unsigned cheques, drafts, notes, acceptances and other instruments and orders with respect of any funds at any time to the credit of Geneva with the Bank. The Board of Directors also resolved that the Bank was authorised to pay and debit cheques, drafts and orders from the Geneva Account without enquiry as to the circumstances of their issue or for the disposition of their proceeds if the same were signed by DS and Mr. Ritter. The Board of Directors also resolved that DS and Mr. Ritter, if they signed together, were authorised on behalf of Geneva to enter into any agreement relating to any general or specific transaction at the Bank. The Board of Directors further resolved that DS or Geneva's Assistant Secretary were authorised and directed to certify to the Bank the names of persons authorised to sign for it[5] and to provide them with specimens of their signatures. The Board resolved that the Bank should be fully protected in relying on the above certifications including the signatures and would be:

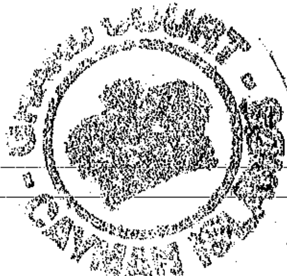
> *"indemnified and held harmless from any claims, demands, expenses, loss or damage resulting from or arising out of or in any signature so certified..."*

19. The purpose of the document was to record the resolutions of the Board of Directors of Geneva in relation to its dealings with the Bank in relation to the Geneva Account. The Bank does not accept the Plaintiffs' contention that:

[5] In the resolution this certified it was DS and Mr. Ritter.

(i) there is a resultant implied term that, for any document to be valid in relation to any banking transaction instruction, DS and Mr. Ritter had to sign it; and

(ii) that, for any agreement with the Bank relating to banking services to be binding on Geneva, that agreement also had to be signed by DS and Mr. Ritter.

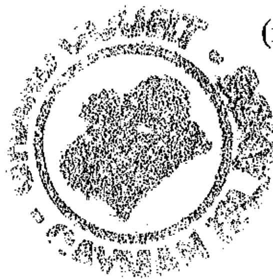


The Bank contends that agreements between Geneva and itself can be entered into by anyone with actual or ostensible authority to bind Geneva in accordance with normal principles in company law. If DS and Mr. Ritter had together duly authorised only one of them to sign a document or contract, then only one signature would be required. It is contended that there is an express term that DS, as Geneva's Secretary, is authorised to certify to the Bank the names of the present officers of the company and other persons authorised to sign for it. It is also contended that a further express term is that all business conducted between the Bank and Geneva is subject to the General Regulations and Conditions ("the Regulations") for conducting business with the Bank and that a copy of the same may be executed and agreed by DS in his role as Secretary of Geneva.

20. The Bank also does not agree with the Plaintiffs' contention, arising from the Resolution document, that:

(i) there is a further implied term that the Bank had no authority to accept or approve any account opening document or agreement unless it was signed by Mr. Ritter and DS;

(ii) there is no authority to accept the Regulations signed only by DS as Company Secretary; and

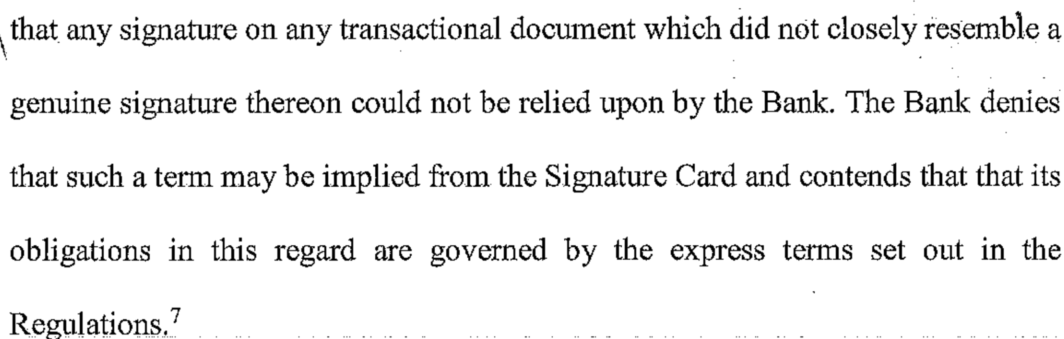


(iii) there is no authority to accept an Online Banking Application signed only by DS. The Bank reiterated that the Resolution provided that all business conducted be subject to the General Regulations and Conditions and that these were duly signed by DS.

21. The Plaintiffs further contend that there is an implied term from the Resolution that the Bank had no authority to pay or debit any cheques, drafts orders from the Geneva Account without enquiry unless they were signed by both Mr. Ritter and DS and that the Bank was required to compare the signatures carefully with the certified signatures on the Signature Card. The Plaintiffs submitted that the Bank could not rely upon the indemnity set out in the resolution if it honoured a signature which was not a certified signature as evidenced by the Signature Card. The Bank denies that the contents of the Resolution can amount to these implied terms. The Bank rightly submits that it need only make enquiries as to the circumstances of payments out of the account where there is reason to believe that the transaction was fraudulent or was suspicious. The Bank accepted that its contractual obligation was to make sure that instructions had been authorised in accordance with the mandate. The Bank also states that the standard of care for its

employees is not one of "*carefully*" as suggested by the Plaintiffs, but is one that requires them to exercise reasonable skill and care.

22. The Fourth Account Opening Document is the New Account Signature Card ("the Signature Card")[6]. Pursuant to the express terms of the Resolution, DS and Mr. Ritter each wrote their names and placed their signatures on the Signature Card. It is contended by the Plaintiffs that it was an implied term of the Signature Card that any signature on any transactional document which did not closely resemble a genuine signature thereon could not be relied upon by the Bank. The Bank denies that such a term may be implied from the Signature Card and contends that that its obligations in this regard are governed by the express terms set out in the Regulations.[7]



23. Mr. Ritter contends that for a two signatories account the Bank should have had his contact telephone number as well as DS's. During cross-examination this was put to Mr. Skinner, Head of Corporate Banking at the Bank since 2011, and he answered that the standard practice for banks is to usually only have one point of contact and number to call for a company. Mr. Skinner added that for captive insurance companies, where the owners or shareholders are in the USA, they often do not wish to give their contact details for tax reasons. He stated that it was "*exceptionally rare*" for there to be a fraud between two authorised signatories named on a particular account. This is a factor to take into account when one

[6] Documents Bundle Volume 1 - Tab 14.
[7] See Regulation 11 - see paragraph 27 herein.

considers whether the Bank was dishonest and wilfully closed its eyes to the transactions on the Geneva Account at a time when it was not known by anybody that DS was a fraudster.

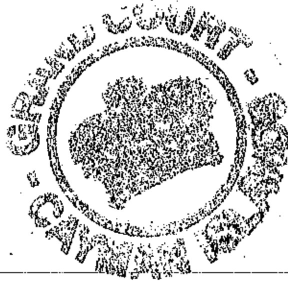
24. As mentioned above in paragraph 17 DS's numbers were provided as the point of contact in the Memorandum. Mr. Skinner said that the Bank's call-back procedure is not designed for a situation where the designated contact is the person committing the fraud. So following the right procedure in this matter, if there was to be a call back, Mr. Skinner clarified that it would have been to DS who at the time of the relevant transactions was not a known fraudster. This standard banking practice is a further factor to take into account when considering the issue of dishonesty raised by the Plaintiffs.

25. The Fifth Account Opening Document is the General Regulations and Regulations for Conducting Business with the Bank[8] which was signed, as per the Resolution[9], by DS in his capacity as Geneva's Secretary around 20 March 2008. The Plaintiffs are wrong when they state that the Resolution was ambiguous and that DS's signature was not sufficient as Mr. Ritter's signature was also required. In the Plaintiffs' Amended Statement of Claim they refer to Regulations 3, 5, 10 and 11.

26. Regulation 5 provides:

[8] Documents Bundle Volume 1 - Tab 15.
[9] Which were signed by both DS and Mr. Ritter.

> *"The Bank is entitled, but is not obliged, to rely upon an act in accordance with any notice, demand or other communication which may from time to time be given by any verbal, telephone, telegraphic, telex or electronic message is believed by the bank to be genuine and be presented or delivered by on behalf of the customer, without incurring liability should be false or there be any error or ambiguity therein."*



The Plaintiffs contend in their Amended Statement of Claim that if reliance is placed by the Bank on this Regulation in avoiding all liability for the reliance on any notice or other communication supposedly made on behalf of Geneva, any subjective belief held by it or its employees that such a notice or communication was presented or delivered on behalf of Geneva, would have to be a reasonably held and honest belief that it was so made.

27. Regulation 11[10] deals with how the Bank verifies the signature as follows:

> *"The Bank verifies the signature by comparing it with the specimen on file. The Bank shall be entitled but not required to go beyond such verification. The Bank shall not be liable consequence of forgery unless such forgery should through observance of due diligence have been readily detected."*

The Plaintiffs claim, if the Bank seeks to rely upon this Regulation to avoid all liability flowing from the forgery, that it is an implied term of this Regulation that the Bank must demonstrate that it had observed due diligence in its efforts to detect the forgery. The Bank claims that it is not an implied term and in fact it was

[10] See paragraph 22 herein.

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an express term of the Contract that it would not be held liable for consequence of forgery unless the forgery could, through due observance of due diligence, have been readily detected and that it had an obligation to observe due diligence.

28. The Plaintiffs contend that they are not bound by the Regulations and that the Bank cannot rely upon them to avoid its liability for reasons that will be expanded on later herein. In the alternative, the Plaintiffs argue that if the Regulations are held to be binding then they were unusual and onerous clauses which were not properly notified to them and therefore they cannot be relied upon by the Bank. Mr. Ritter claims that DS never showed him a copy of the document, if that is right, the fault for that cannot be laid at the door of the Bank. I note that when talking about July 2008 Mr. Ritter said that:

> *"I had no reason to doubt (DS) or his honesty as a professional insurance manager"*

and the Bank were entitled to share his view at that time. The Bank claims that the Plaintiffs were properly notified and have actual notice of the Regulations which were signed by DS on 20 March 2008. The Bank submits that the Regulations are sufficiently clear and unambiguous and that it is entitled to rely on instructions given to it if it believed those to be genuine and presented on behalf of the customer and it is not liable for any forgery if it compares the signature with the specimen on file and observes due diligence.

29. The Sixth Account Opening Document is the Online Banking Application[11] which was completed and signed by DS on 20 March 2008 in his capacity as the Secretary of Geneva. Mr. Ritter also claims that this was never sent to him and he submitted that the entry on the form in which DS nominated himself as administrator for online banking purposes authorised to sign the Online Banking Application contradicted the two signature requirement in the Resolution.

30. The Account Opening Documents were sent by Monkton to the Bank on 20 March 2008 and they were accepted by the Bank on or around 28 March 2008.

Background – The Nine Fraudulent Transactions on the Geneva Account between 28 December 2008 and 14 September 2010 – The Bank's Processing Procedure

31. It is agreed that the relevant fraudulent transactions are as follows:

(i) 28 December 2008; US$148,180.74 - DS forged Mr. Ritter's signature on a wire transfer instruction, in the form of a faxed letter, to Warco who were also a client of Monkton and who were also a customer of the Bank. At the time of processing DS described the payment on the instruction as being: " *...in respect of the Quota Share Reinsurance Premium Due.*" Mr. Ritter states that the forgery of the signature is a poor one and that anyone paying attention at the Bank should have detected it when comparing it with his genuine signature. He stated that if the Bank had then contacted him to verify the signature and the transaction he would have confirmed that it was not authorised and the fraud would have been halted at its

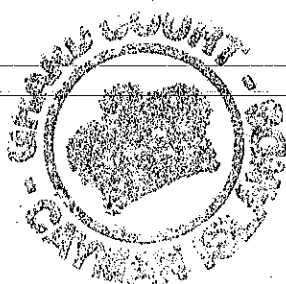
[11] Documents Bundle Volume 1 - Tab 16.

inception. Mr. Ritter contends that captive insurance companies do not transfer funds to each other, and it was irregular or questionable for it to have been done. However, during cross examination he accepted that it could be possible that two captive insurers purchase reinsurance together and then share the premium.

Mr. Skinner contends that the signature was not an *"obvious"* forgery and that the content of the instruction would not 'raise any alarm bells' for a processing bank employee in the situation where the Bank was unaware of any misappropriation on the Warco account, as it would not be unusual for a regulated insurance manager to transfer money from one captive to another, especially as the stated purpose of the transfer on the instruction would be consistent with that. Mr. Skinner pointed out that, from the face of the document, one could deduce that two authorised staff members from the Bank had reviewed the transaction.

Mr. Skinner does not agree that captive insurance companies do not transfer funds to each other, and it was irregular or questionable for it to have been done. He referred to the Shoreline Loan which was approved by Mr. Ritter when he signed the wire transfer on 24 July 2008 authorising US$300,000 to be transferred to Shoreline Commodity Trading. However, Counsel for the Plaintiffs rightly highlights that Shoreline Commodity Trading was not a captive insurance company.

In any event, the Plaintiffs concede that these funds were repaid by means of the below mentioned transaction carried out on a 23 June 2009 and that the amount was therefore not lost and is not claimed.



(ii) 23 June 2009; US$148,180.74 – DS, by letter of instruction sent by email, authorised the Bank to repay the six months earlier fraudulent transfer outlined in paragraph 31(i) above from the Warco account to the Geneva Account. This transfer did not involve a forged signature and both of Warco's authorised signatories had signed this transfer request. At the time of processing DS described the payment on the instruction as being an *"inter-company loan"*. Mr. Ritter contends that a transfer of this sum of money by one of Monkton's managed captives to another should have been viewed as being unusual activity.

Mr. Skinner contended that inter-company loans are not uncommon and, having regard to the procedures in place, a bank employee would not find the instruction to be unusual or irregular. He added that although it is for the same amount as the transfer made six months earlier that would not necessarily make it unusual. I accept Mr. Skinner's evidence in this regard and do not find that the Bank acted dishonestly or was 'closing its eyes' by any employee not regarding this transaction as being 'a red flag' and allowing the transaction to process.

(iii) 31 July 2009; US$16,250 - DS forged Mr. Ritter's signature on a wire transfer to Monkton's Cayman National Bank account contained in a

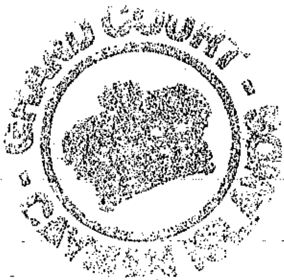
formal Request for Wire Transfer Form. At the time of processing DS described the payment on the Form as being for *"Management fees"*. Mr. Ritter contends that the signature if compared to the one on the signature card is "*very clearly*" not the same signature. Mr. Skinner contends that it is not an "*obvious forgery.*"

(iv) 17 August 2009; US$30,050 - DS again forged Mr. Ritter's signature on a wire transfer instruction to Monkton's Cayman National Bank account contained in a formal Request for Wire Transfer Form. At the time of processing DS gave the details of the payment on the instruction as *"F/F/C Monkton Insurance Services"* with no further elaboration. It is contended by the Plaintiffs that if this and the 31 July 2009 transfers totalling US$46,300 were for management fees, then that would be an abnormally high amount for Geneva to have paid in a 19 day period. Mr. Ritter again contends that the signature, if compared to the one on the signature card, is very clearly not the same signature. Mr. Skinner contends that it is not an "*obvious forgery.*"

Mr. Skinner said that this would not be considered an abnormal amount for management fees and in any event the Bank would not be aware of the arrangements between Geneva and its insurance managers. Mr. Skinner states that the bank employee processing the transaction would not be expected to check when the last management fee was paid or carry out the exercise of totalling the transfers instructed to be made under this head. He

added that the system at the Bank would not have picked up cumulative amounts for the same beneficiary.

Again, in light of the evidence of Mr. Skinner which I accept, I do not find that the Bank acted dishonestly or was 'closing its eyes' by any employee not regarding this transaction, or this transaction coupled with the 31 July 2009 transaction, as meriting further enquiry and allowing the transactions to process.



(v) 29 October 2009; US$16,581.72 - DS forged Mr. Ritter's signature on a wire transfer instruction to Monkton's Cayman National Bank account. At the time of processing DS again gave the details of the payment on the instruction as *"F/F/C Monkton Insurance Services"* with no further elaboration. Mr. Ritter contends that the forged signature is very poor and looks like it has been photo-shopped. Mr. Ritter stated that if a proper comparison had been carried out with the specimen signature the fraud would have been detected. However, during cross-examination Mr. Ritter accepted that "*it was more than likely*" that the two bank officers who conducted the verification process on this transaction concluded that the signature was within either a known or natural range of variation rather than noticed that the signature was obviously forged.

(vi) 18 December 2009; US$435,100 - DS forged Mr. Ritter's signature on a wire transfer to Monkton contained in a formal Request for Wire Transfer Form. At the time of processing DS described the payment on the instruction as being *"Capital Funds for Captive"*. Mr. Ritter contends that

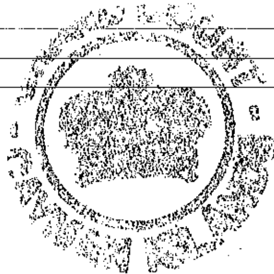
the signature on the request clearly does not resemble his signature on the account opening documents and the fraud should have been detected by the Bank. Mr. Skinner stated that the signature may have been regarded by the staff as being a natural variant of the signature, but he accepts that, now that they are being challenged and it is known that DS, the point of contact, was a fraudster, they may have invited further inquiry. Mr. Ritter also highlights the size of this transaction, and argues that it should not have been processed simply on the telephone verification by DS but only after contacting him also.

Mr. Skinner points out that if a transaction exceeds US$100,000 where the beneficiary is someone other than the account holder, the Bank must telephone the account holder. In this case the account holder was Geneva and not Mr. Ritter personally and the Bank telephoned the contact phone numbers recorded on the client file, namely Monkton's and DS numbers. No number was provided for Mr. Ritter, so the Bank would not have contacted him. It is clear from the New Account Memorandum form which had been signed by Mr. Ritter, that Mr. Ritter agreed that DS would be the point of contact for the account.[12] In any event, Mr. Skinner says that there is no requirement to contact every signatory on the account. Mr. Skinner added that, despite the amount, there is nothing unusual or irregular in this transaction as it involved a regulated insurance manager transferring money to itself for capital for another captive, which appears to be for a captive insurance related payment.

[12] See paragraphs 17 and 24 above.

Mr. Skinner's evidence in this regard does not point to a wilful closing of eyes, but to the adoption of established process when transacting larger sums of this amount.

(vii) 14 July 2010; US$16,205 - DS forged Mr. Ritter's signature on a wire transfer instruction to Monkton. At the time of processing the DS described the payment on the instruction as being *"Management Fees"*. Mr. Ritter contends that the signature on the request is *"poorly forged"* and very clearly not the same as his one on the account opening documents. The Bank forthrightly accepts that this signature may, in the present circumstances where one is aware of what one knows now, have merited further inquiry.

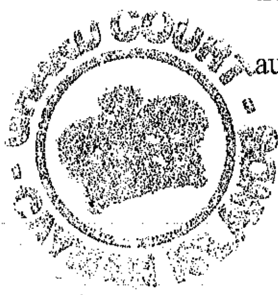


(viii) 3 August 2010; US$15,005 - DS forged Mr. Ritter's signature on a wire transfer instruction to Monkton. At the time of processing DS again described the payment on the instruction as being *"Mgmt fees"*. Mr. Ritter contends that if one looks at the copy of the document a faint box appears, giving the impression that the signature had been cut and pasted from another document and that *"this is another instance of the banker parties shutting his eyes to obvious fraud"*. Mr. Ritter accepted that there is a clearer copy of the allegedly photo-shopped document which, if produced, may have made it clearer whether his belief had actually occurred. The Bank contends that this is not an obvious forgery and that one cannot deduce, due to the quality photocopy of this faxed document, whether it contains a cut and paste signature.

(ix) 13 September 2010; US$47,804.56 - DS forged Mr. Ritter's signature on a letter instructing the Bank to issue an international draft payable to J.E Elliott. At the time of processing DS described the payment on the instruction as *"Policy loan"*. Mr. Ritter contends that on careful scrutiny one can see that the signature on the letter of instruction is again cut and pasted. Mr. Skinner again submits that there is no reason why any employee would view these instructions as being unusual or irregular or see the need to question why a regulated insurance manager was transferring money to a person for a policy loan.

32. Mr. Ritter summarises that the above-mentioned forgeries of his signature were so obvious, that the Bank was being "*wilfully blind to the fraud*" when allowing the "*irregular transactions*" in and out of the Geneva Account, and accounts of other DS/Monkton managed client companies to go through. It is contended that the transactions were outside the normal course of business for a captive insurance company and/or were highly irregular and suspicious and, as a result, the Bank must have deliberately or recklessly turned a blind eye and have therefore acted dishonestly. The Plaintiffs correctly contend that when considering the facts the Court should consider the Bank's actions or inaction in the context of it holding itself out to be a specialist in the financial services industry in the Cayman Islands.

33. Mr. Skinner provided some detail about the Bank's general wire transfer procedures which he believes would have been followed in relation to the relevant transactions now before this Court. It is rightly contended that the procedures and the facts in this case must be put into context where the staff members at the Bank have to process around 20-30 wire transfers per day for corporate clients and around 8,000 wire transfers per month for clients in all divisions of the Bank. Mr. Skinner opines that, bearing this in mind, the appropriate validation enquiries cannot and do not require a detailed review and cross reference of each and every transaction. Mr. Skinner understandably stated that attempted fraud by an authorised signatory like DS is:



> "*extremely unusual...and difficult to detect, mostly because the Bank has to operate from a basis of trust with a known authorised signatory*."

There is force in this statement, especially when considering whether the Bank has dishonestly assisted DS by not stopping the transactions.

34. The first step of the wire transfer procedure is when a faxed request for a wire transfer is received by the Corporate Banking Team or by Central Operations. The staff member is required to check whether there are sufficient funds in the account, that the signatures are verified, that the account numbers are correct and that there is no notation or block on the account preventing wire transfers. On occasion, the verification process may require the staff member to get in touch

with the customer's designated point of contact for the account. This additional procedure may be used where:

(i) the transaction appears unusual;

(ii) where there appears to be some difference between the signature(s) and the provided specimen signature(s);

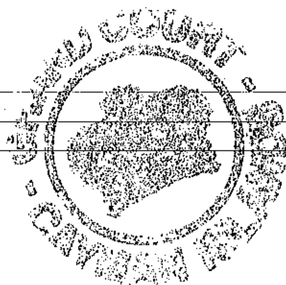
(iii) where the transfer sum is over US$100,000; or

(iv) where attempted fraud is suspected.

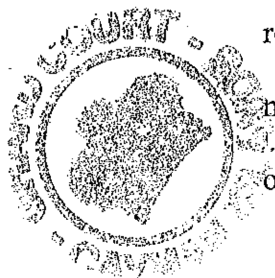
This call-back procedure was introduced in 2006 but the requirement for a stamp to be placed on the request confirming that the procedure was not introduced until 2011, so after the last relevant fraudulent transaction in the matter before me. Mr. Skinner indicated that if the request is received from a known customer contact, fax number and location (as they were in the matter before me) and it appears that it is signed by the authorised signatories, then the processing member of staff would ordinarily be content about its validity and sign and stamp the document before passing it on to another officer. If the initial member of staff had concerns then he would be obligated to refer it to more senior members of the banking team.

35. The second bank official who must look at the request carries out the same verification exercise as that conducted by the first, before also signing the request document. If the second official feels there are any irregularities or anything is unusual he should refer the request to a senior officer.

36. Once the second officer has given his approval the initial officer will send the document to the Payment Central Operations Department for processing. Under the current procedure, that Department should only accept the request if it is evident from the document that at least two officers have signed it to signify that they have carried out the required checks. If the officer in Department is so satisfied, after an Administrator has entered the SWIFT details on the request, the wire details are entered into the banking system by an Input Clerk. The request is then seen by a third employee in the Department who is a supervisor or manager who authorises the transaction in the system and initials the request form.



37. Mr. Skinner, who I found to be a reliable witness as it relates to established banking practices, goes so far as to say that if he had been asked to approve any of the above transactions at the time that they were requested, he would have done so as on the face of them no suspicions would have been raised. Although Geneva's audited accounts for 2005 and 2006 show the management fees were for a lesser sum in the region of US$15,000, Mr. Skinner rightly states that the Bank's processing team could not be expected to review Geneva's audited accounts to satisfy themselves that the level of management fees in some of the above transactions were appropriate for the industry. I do not accept that under the Bank's Policy and Procedure a review of audited accounts is strictly required when using "all reasonable means" to ascertain likely account usage. It is for the customer when opening the account to inform the Bank about the expected level of activity. Accordingly, the fact that a bank employee did not conduct such a



review for, what were much later disclosed as being fraudulent transactions, does not amount to a closing of eyes and is not sufficient to base a finding of the nature of dishonesty required[13] to prove a dishonest assistance claim.

38. Mr. Skinner accepts that some of the signatures on the various requests, especially with the benefit of hindsight and now knowing that the signatures are being challenged with more time to study the request in detail, "*do vary to a degree which might have invited enquiry*" and states that there was no evidence of dishonesty but more likely to be *"innocent error*." Mr. Ritter submits, although not accepted by the Bank, that this is an admission of negligence on the part of the Bank. Mr. Skinner states that, having regard to the procedures in place and the volume of wire transfer requests, the banking officers have not processed the transactions improperly and that even if they had noticed any variation in the signatures that the standard practice would have required them to call DS who was the point of contact for Geneva with any request for Mr. Ritter to re-sign the document. The frank admission by Mr. Skinner that the signatures might have invited enquiry, in circumstances where there is more clarity with hindsight and in context due to what we know about the established fraudulent conduct of DS, the agreed point of contact for this account who Mr. Ritter and the Bank regarded at the time to be an honest officer of Geneva, does not prove that the Bank through unidentified member(s) of its employees were dishonest or closing their eyes in their approval or handling of the transactions

[13] As highlighted from paragraph 180 herein.

Background - Events in August to September 2011

39. Mr. Ritter told the Court that in August 2011, due to his dissatisfaction with the level of service being provided to Geneva by Monkton coupled with a change in the law in Texas in 2005, he had decided to wind down Geneva's operations in the Cayman Islands and to close the Geneva Account and transfer the funds therein to the USA. Mr. Ritter also said that a further reason for making the decision was because DS become increasingly unresponsive to his phone calls and evasive, specifically in relation to providing the necessary information for the completion of the long outstanding 2007 and 2008 audit of Geneva by its auditors, BDO Tortuga ("BDO"). One might have thought that such a concern and state of affairs in relation to Geneva, one which the Bank could not have known about at the time, should have raised some alarm bells for Mr. Ritter concerning DS's handling of Geneva's finances and whether this merited scrutiny by him.

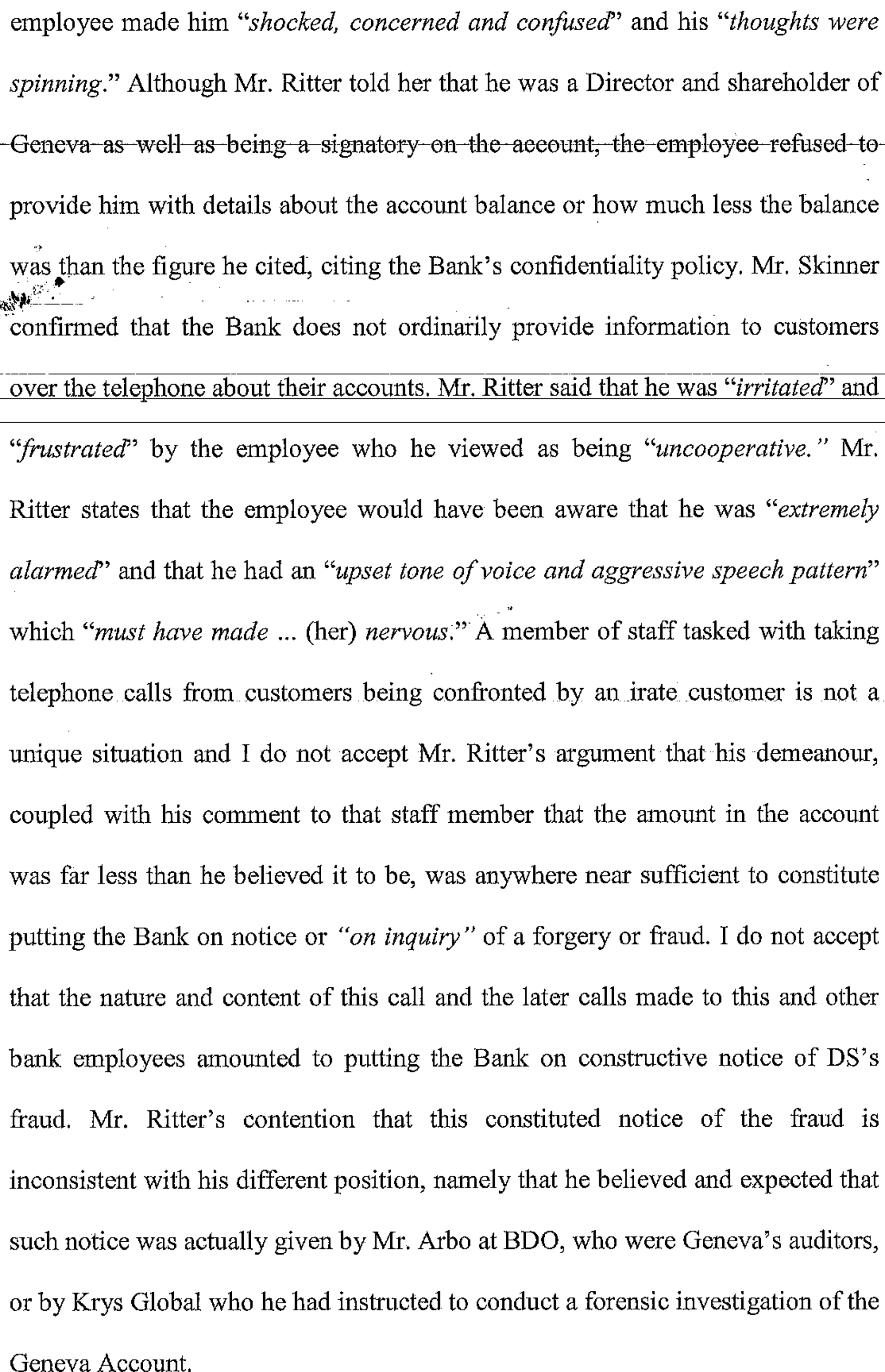
40. Mr. Ritter states that he informed DS that Geneva's three brokerage accounts at Abshier Webb Donnelly Baker should be closed and the funds should be transferred to the Geneva Account. The transferred funds totalling US$510,062.90 resulting from the closure of the accounts were credited in the Geneva Account on 16 August 2011. Mr. Ritter says that, between 16 to 23 August 2011, he informed DS of his wish to close the Geneva Account and transfer the funds to the USA. At that time, based on the bank statements provided to him by DS, Mr. Ritter believed there to be around US$1,495,000 in the Geneva Account.

41. Mr. Ritter stated that, when he informed DS of his intentions, DS told him that the maximum which could be withdrawn from the Geneva Account in August 2011 was US$620,000, because CIMA had imposed minimum capital requirements for captive insurance companies. Mr. Ritter told DS that he still wished to close the Geneva Account, to debit the US$620,000 and have the balance of around $875,000 transferred thereafter. Accordingly, albeit belatedly at around 1:01 PM[14] on 1 September 2011, US$620,000 was transferred from the Geneva Account to Mr. Ritter's account in the USA.

Background - Events on 1 September 2011

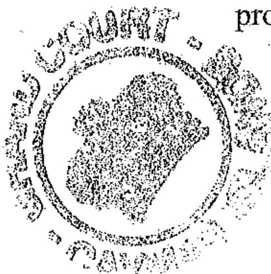
42. At around 10:31 AM on 1 September 2011, before the transfer had been processed, Mr. Ritter telephoned the Bank to ascertain the account balance. When he was put through to the Bank's Corporate Banking Department he was informed by an employee that the same was "*far less*" than the figure he had given to her. Mr. Ritter argues that the Bank had thereby been put on notice that there was an US$872,000 shortfall on the account. In his oral evidence, Mr. Ritter rightly conceded that he had not informed the employee that sums in the account had been withdrawn without his knowledge or consent. Although Mr. Ritter, after the employee's limited disclosure to him about the account, may have been able to then express a view that this is what must have caused the reduced account balance, he of course could not put, and cannot say that he put, the Bank on notice of the forgery or fraud, as he was not aware of the same at the time, as this was before DS had confessed to him. He said that the information received from the

[14] The wire transfer instruction having been received by the Bank at 12:32 PM.



employee made him "*shocked, concerned and confused*" and his "*thoughts were spinning*." Although Mr. Ritter told her that he was a Director and shareholder of Geneva as well as being a signatory on the account, the employee refused to provide him with details about the account balance or how much less the balance was than the figure he cited, citing the Bank's confidentiality policy. Mr. Skinner confirmed that the Bank does not ordinarily provide information to customers over the telephone about their accounts. Mr. Ritter said that he was "*irritated*" and "*frustrated*" by the employee who he viewed as being "*uncooperative.*" Mr. Ritter states that the employee would have been aware that he was "*extremely alarmed*" and that he had an "*upset tone of voice and aggressive speech pattern*" which "*must have made* ... (her) *nervous*." A member of staff tasked with taking telephone calls from customers being confronted by an irate customer is not a unique situation and I do not accept Mr. Ritter's argument that his demeanour, coupled with his comment to that staff member that the amount in the account was far less than he believed it to be, was anywhere near sufficient to constitute putting the Bank on notice or *"on inquiry"* of a forgery or fraud. I do not accept that the nature and content of this call and the later calls made to this and other bank employees amounted to putting the Bank on constructive notice of DS's fraud. Mr. Ritter's contention that this constituted notice of the fraud is inconsistent with his different position, namely that he believed and expected that such notice was actually given by Mr. Arbo at BDO, who were Geneva's auditors, or by Krys Global who he had instructed to conduct a forensic investigation of the Geneva Account.

43. Interestingly, in an email sent to Krys Global on 6 September 2011, Mr. Ritter informed them that he had not spoken with the Bank "*at all on the matter.*" During evidence in chief he elaborated on the content in his email stating his view that it was very clear to the first bank employee that there was a significant problem on the account, but then went on to say:



> "*I have never told the bank that there had been a forgery, nor had I told the bank some of the intervening things that had gone on since my awareness there. And so I am now saying to Margot, I haven't spoken to them on this matter.*"

44. Mr. Skinner indicated that the bank employee who took Mr. Ritter's first two phone calls had followed the correct procedure in not providing confidential account information, although with hindsight she could have suggested that he speak to the Relationship Manager for the Geneva Account. If Mr. Ritter was unhappy with the service he was receiving from this employee and so concerned about the account, one might have expected him to ask her if she could connect him with a more senior member of staff, something which he chose not to do.

45. As a result of what he had been told by the Bank's employee, Mr. Ritter spoke to DS on the phone at 10:39 AM and again at 10:46 AM. They had about eight further brief telephone conversations on that day. DS informed him that he "*borrowed money*" from the Geneva Account and, although not using the word "*forgery*", he admitted that he had signed Mr. Ritter's name when doing so. DS informed Mr. Ritter that he would make immediate arrangements for the sums to

be repaid, and DS, despite being initially evasive, during one of the later telephone conversations on that day confirmed that the amount owing was about US$875,000 which he promised to repay.

46. At this stage on 1 September 2011, following some of the eight calls between Mr. Ritter and DS, but before Mr. Ritter's second telephone call to the Bank at 12:39 PM, DS embarked on further fraudulent activity on accounts at the Bank by initiating the transfer of funds from two captives also managed by Monkton to the Monkton account at the Cayman National Bank in order to fulfil his promise to Mr. Ritter to repay the money removed from the Geneva Account into his personal account. DS actually instructed a transfer of US$550,000 from the account of Warco to Monkton at 11:47 AM and a transfer of US$276,000 from the account of Canadian Livestock at 12:32 PM to Monkton. As there was no notice or block on the accounts operated by DS, which Mr. Skinner stated would have been put in place if Mr. Ritter had notified the Bank about his knowledge of the forgeries, these transfers were not questioned and were processed in the normal way. In relation to the Warco and Canadian Livestock transactions, the entries on the face of the document indicate that the Bank conducted a call-back to verify the transaction. The transaction, which Mr. Skinner stated would have been viewed at the time by bank processing staff working with such a corporate customer as a payment being made for a legitimate commercial purpose, was actually authorised by the signatories, so was not a forgery. The transactions were likely completed around 12:10 AM on 2 September 2011.

47. Wire transfers of US$75,000 and US$225,000 were received on Monday, 7 September 2011 and a wire transfer of US$575,000 was received on 7 September 2011 from the Monkton account at Cayman National Bank by Mr. Ritter into his personal US account. It is common ground that these payments totalling $875,000 had been misappropriated by DS using the two above-mentioned transfers from the accounts of captive insurance clients of Monkton at the Bank. Mr. Ritter said that he had been led to believe by DS that the funds would be coming from DS's family members in the United Kingdom and it was not until he read the Confidential Report of the Monkton Controllers dated 21 February 2012 that he became aware that the funds had been stolen.

48. Mr. Ritter states that, after his initial telephone conversations with DS, he again telephoned the Bank and had a thirteen minute conversation with the same bank employee commencing at 12:39 PM. Importantly, Mr. Ritter was at this time already aware of the forgery on the account, as DS had admitted it to him. He conceded during cross-examination that at that point, in his mind, it was "*a fraud and a forgery*". It is therefore rather surprising that in a letter of 29 September 2015 from Mr. Ritter's attorney to the Bank's attorney, presumably written on instructions, it was stated that the Bank had not been informed of the admitted fraud by Mr. Ritter in September 2011 because it was "*premature and imprudent*" to do so prior to an investigation and that it was "*only a suspected fraud.*" Mr. Ritter indicated that the employee again refused to provide him with the amount of the balance in the Geneva Account, indicating to him that she had "*told [him]*

too much already" and was not permitted to verify his identity over the telephone. Mr. Ritter failed to tell the bank employee what he had just been told by DS about the forged signatures, something he accepted during cross-examination. Mr. Ritter said that the employee did not offer or suggest transferring his call to a manager or anyone more senior, but on the other hand, there is no evidence that Mr. Ritter asked her during this telephone call to transfer him to speak with a manager or a more senior officer. This is surprising, as Mr. Ritter says that he was extremely dissatisfied with the two telephone calls he had with this employee. One would have expected a seasoned businessman in the financial industry, such as Mr. Ritter, to have asked to speak to the Fraud Department at the Bank as DS had informed him about the forgery, especially if he was so dissatisfied with the more junior bank employee with whom he had been speaking and was so concerned about the account. Mr. Skinner understandably said that he would have expected a person in Mr. Ritter's position, with the knowledge he had due to DS's confession to him, to:

> "*be bashing the door down to get to a very senior person to report of fraud – forgery.*"

49. At 1:01 PM Mr. Ritter telephoned the Bank's switchboard, this time he asked to speak to someone in the Wire Transfer Department. He had a fourteen minute discussion during which he was informed that the instruction for the US$620,000 wire transfer had been received. This employee was also not willing to provide Mr. Ritter with the figure for the remaining balance in the Geneva Account. He

said that this employee "*also*[15] *declined*" to refer me to someone more senior in the Bank who could assist him. However, it is not clear whether Mr. Ritter had actually asked to speak to someone more senior in the Bank or whether, like with the first employee, that employee did not offer or suggest transferring the call to a senior bank officer.

50. Mr. Ritter made his fourth telephone call to the Wire Transfer Department at the Bank at 2:29 PM, at which time a further bank employee confirmed in a three minute conversation that the wire transfer had been processed, but similar to her colleagues, refused to give him any details about the balance in the Geneva Account. Mr. Ritter said at that stage he gave up trying to receive any co-operation or assistance from the Bank, as he believed the staff's attitude to be unhelpful and it actually made him:

> "*wonder if (DS) had had any inside help from the employees at the bank, in undertaking whatever it was (DS) had done on the Geneva Account.*"

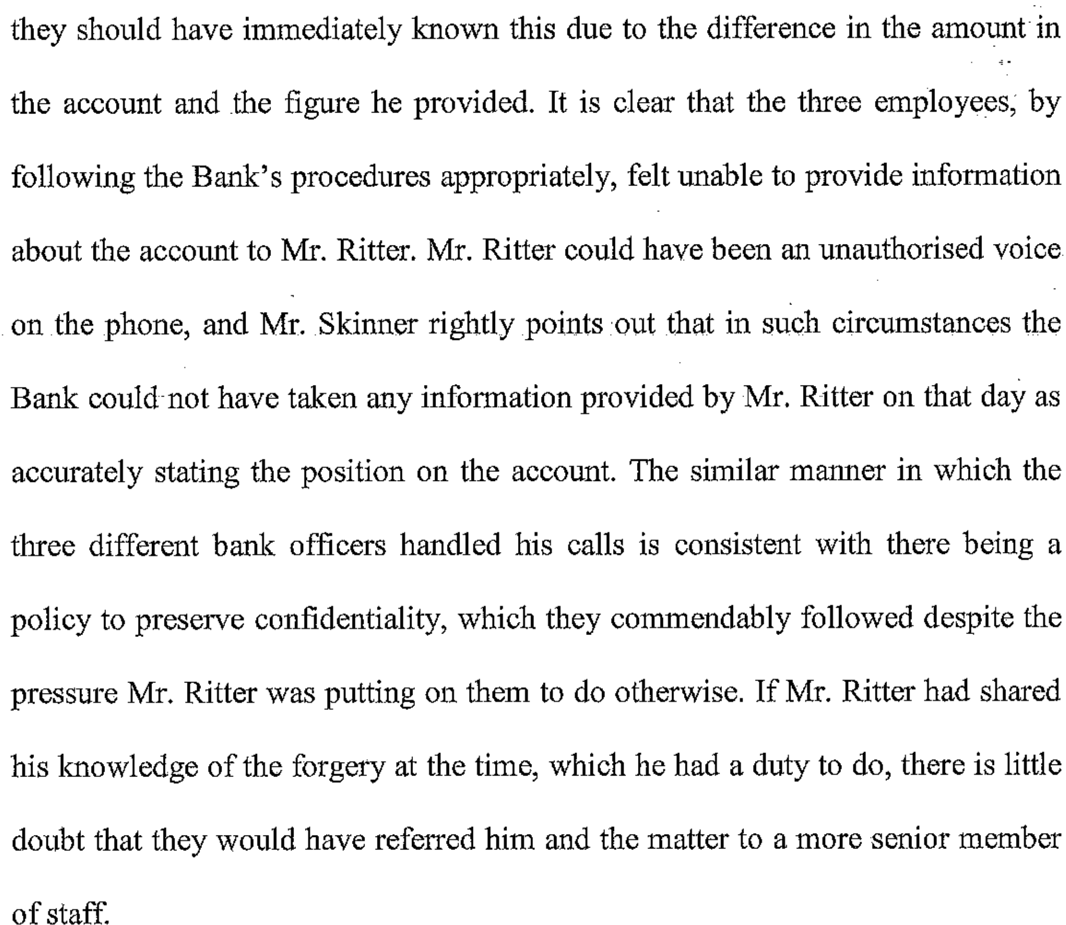
There is absolutely no evidence that anyone employed by the Bank had acted in such a way. In fact, in his statement sworn on 8 December 2016 Mr. Ritter states that:

> "*I have never formally alleged and do not allege now that (DS) had an accomplice - fraudster in the corporate banking team at Butterfield, and I do not seek to impeach the bank's reputation in this way.*"

[15] My emphasis by underlining.

During her opening submissions at the hearing Mr. Ritter's counsel conceded that an allegation that DS had "*inside help*" at the Bank was not being pursued.

51. Mr. Ritter characterised the employees' responses as being "*unhelpful*" and like a "*recorded script*". Mr. Ritter wrongly contends that he had, by the above conversations with the three different members of staff, put the Bank on notice of money being withdrawn from the Geneva Account without his consent and that



they should have immediately known this due to the difference in the amount in the account and the figure he provided. It is clear that the three employees, by following the Bank's procedures appropriately, felt unable to provide information about the account to Mr. Ritter. Mr. Ritter could have been an unauthorised voice on the phone, and Mr. Skinner rightly points out that in such circumstances the Bank could not have taken any information provided by Mr. Ritter on that day as accurately stating the position on the account. The similar manner in which the three different bank officers handled his calls is consistent with there being a policy to preserve confidentiality, which they commendably followed despite the pressure Mr. Ritter was putting on them to do otherwise. If Mr. Ritter had shared his knowledge of the forgery at the time, which he had a duty to do, there is little doubt that they would have referred him and the matter to a more senior member of staff.

52. Importantly, what Mr. Ritter failed to do in any of the three telephone calls lasting a total of forty minutes which he made to the Bank after DS had admitted his

fraudulent actions by forging Mr. Ritter's signature to him was to inform the Bank about what DS had told him. In fact during cross-examination Mr. Ritter agreed that:

> "*if he had intended to tell the Bank about the admission of forgery*", these three calls were a "*perfect opportunity*" for him to have done that.

Mr. Ritter later added that he agreed "*in general*" with the proposition that if in a personal banking situation there has been a fraud on one's account, one should call the Bank immediately to let them check the compromised account and that this may lead to security measures being put in place by the Bank, including a block being placed on the account. It is clear that the purpose of these calls made by Mr. Ritter was not for him to in any way notify the Bank or put them on inquiry of the forgery or fraud which he was aware of after the first phone call, but for Mr. Ritter to obtain information about the balance on the account. I do not accept the contention that the making of the calls to the Bank by Mr. Ritter and the content of the conversations about the account balances between him and the bank employees:

> "*contrast with the deliberate conduct of the culpable customers in successful estoppel cases.*"

Mr. Skinner correctly contends that Mr. Ritter, in his capacity as a Director of Geneva, had a duty to inform the Bank about the forgery as soon as he had been made aware of it by DS on 1 September 2011 and that he had ample opportunity

to do so during any of the later three telephone calls that he made to the Bank on that day.

53. Mr. Skinner states that if the Bank had been notified of the fraud, then he would have been made aware of the same because any member of staff who received such notification would have reported the matter to a supervisor or senior manager, who in turn would have passed the information on to him. Mr. Skinner would then have informed the Head of Compliance and a block preventing any further transactions[16] would have been placed on the Geneva Account. An investigation would then have been conducted in relation to all accounts to which DS was a signatory, and it is likely that blocks, or at the very least warning notices which would require approvals from senior management before allowing transactions to process on the relevant account, would also have been placed on those accounts[17]. The Head of Compliance at the Bank would then have notified the Financial Crimes Unit ("FCU") and a Suspicious Activity Report ("SAR") would likely have been filed with Financial Reporting Authority. The Bank would have sought legal advice from its attorneys and this would have included advice about how to recover any sums fraudulently removed from the Geneva Account. Mr. Skinner stated that recovery proceedings could have then been brought at a time when DS was still solvent, before any of the later Default Judgments were entered against him and before he had divested his personal assets by the later

[16] Including the two fraudulent transfers detailed in paragraph 47 herein.
[17] Mr. Skinner contends that two payments totaling US$825,000 paid to Monkton on DS's instructions could have been blocked if such notice had been given by Mr. Ritter to the Bank after DS's confession to him on 1 September 2011.

grant of a Power of Attorney in settlement of the later Default Judgment obtained by Monkton JOLs. Any block on the relevant account(s) would not have been lifted unless the Bank received advice to do so by the FCU or the Bank's attorneys.

54. At 3:29 PM, less than half an hour after his last conversation with the Bank and despite him saying that he was in a "*profound state of shock*", Mr. Ritter had the presence of mind to telephone Paul Arbo with whom he had recent contact concerning the preparation of past-due audits for Geneva. In his witness statement Mr. Arbo stated that:

> " ,.. *I recall thinking throughout my conversations with Mr. Mr. Ritter at that time how composed he was, so I did not feel any need to try to calm him down.*"

Mr. Arbo answered in his evidence in chief when asked whether Mr. Ritter was upset:

> "*No, I was actually thinking to myself he was fairly well composed, given the nature of what he was calling me about*",

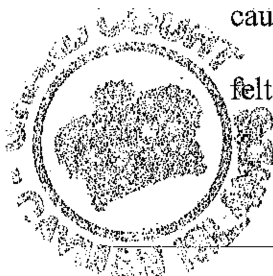
before adding when asked about Mr. Ritter's demeanour between 1 September at 3:29 PM until 6 September 2011 that he remembered that:

> "*he was quite composed.*"

55. It is also clear that Mr. Ritter had the clarity of mind to develop a dual strategy at the time, namely to firstly put pressure on DS to make repayment and not doing anything in relation to reporting to third parties as that might detrimentally affect

that course until he was paid and secondly, if the first option failed, then seek to recover from the Bank. Interestingly, unlike his communications with the Bank on that day, Mr. Ritter chose to inform Mr. Arbo about what DS had told him about his fraudulent actions and the forged signatures. Mr. Arbo confirmed in his evidence that Mr. Ritter told him that he had spoken to DS who had admitted to him that he had taken money out of the Geneva Account by forging Mr. Ritter's signature on cheques.

56. Mr. Ritter stated that he "*remembered clearly*" that Mr. Arbo advised him in their discussion to obtain a full picture and to be in possession of all the facts before doing anything or notifying anyone including CIMA. Mr. Ritter stated that he was at the time "*influenced*" by Mr. Arbo and BDO, in particular when they expressed caution to him "*not to act rashly.*" Mr. Ritter said that he relied upon them as he felt that he was:



> "*in a completely new situation and in an unfamiliar country with the legal system regulatory system I knew almost nothing about.*"

Although the forgeries had commenced in 2008 and although no audits had been completed by BDO from 2008 onwards, Mr. Ritter added that he believed in retrospect that Mr. Arbo was concerned about BDO's reputation as auditors if they had overlooked fraudulent activity and that this was why Mr. Arbo did not want to cause any unnecessary trouble for DS or BDO. In his first written statement, Mr. Ritter wrongly stated that Mr. Arbo suggested that a special audit should take place, and he later accepted that this was inaccurate as in fact he had

been the one to ask Mr. Arbo if he would do the forensic work. When first asked to do that by Mr. Ritter, Mr. Arbo stated that he would have to think about whether he could take on an engagement to conduct a forensic accounting investigation to reconcile the transactions on the Geneva Account.

57. Mr. Arbo's recollection of their discussion is very different. He accepts that BDO had duties as auditors which Mr. Ritter could rely upon. He also accepted in cross-examination that he did not have the sense that Mr. Ritter wanted to cover up this fraud for DS and he was not concerned about DS's welfare. During re-examination he reiterated that reporting to the Bank was not a matter for the auditor and that it was a matter for the client. He added that he was:

> "*under the impression that we had no responsibility to report to Butterfield.*" Mr. Arbo stated "*At no time during discussions with Mr. Mr. Ritter or email correspondence reporting on those discussions was there ever any talk of notifying the Bank or any other parties aside from the regulator and the police. All of the conversations were about BDO's obligation as an accounting firm to report suspicious activity. I do not, therefore, believe that Mr Mr. Ritter could have reasonably presumed or expected that BDO would notify any other party as suggested in paragraph 100A and 102 of the Amended Statement of Claim. This is also inconsistent with Mr Mr. Ritter's specific request to me on 2 September to keep the information confidential and his requests on 5 and 6 September to delay notifying only the regulator and the police.*"

Mr. Arbo was adamant that he did not tell Mr. Ritter to keep knowledge of the forgery and fraud to himself and not to report it, stating during examination in chief:

> *"I'm sure I spoke, generally, about the importance of gathering all facts. And in the kind of context of an essential forensic audit, but certainly not any context of delaying notifying CIMA.*"

Mr. Arbo also denied Mr. Ritter's statement that he had told him that DS had a nephew working as a Chartered Accountant at a competing accountancy firm, which Mr. Ritter said he had done possibly to emphasise that DS was a reputable professional.

58. Mr. Ritter stated that he wished to be *"proactive"*, so at around 3:56 PM he telephoned CIMA's Enforcement and Insurance Company number, having been redirected to them by someone at CIMA whose number he had been able to search for and find, with the intention of reporting the fraud. This is an illustration that he had clarity of thought to partly recognise the obligation to make such a report. He failed to inform the CIMA staff member of his suspicions about DS's irregular dealings with Monkton, stating that *"as he was about to"* do so he terminated the call as he then recalled the "*clear advice*" which he said Mr. Arbo had given to him not to make any serious allegations until he knew the facts. However, very shortly after this call, he telephoned Mr. Arbo at 4:05 PM to request the details of the person at CIMA who was responsible for Geneva. It is

evident that Mr. Ritter's concerns about the Geneva Account did not hinder these lucid thought processes.

59. At 4:09 PM, following the request for the information, Mr. Arbo provided Mr. Ritter with the details of the Head of Insurance Supervision at CIMA who would be responsible for Geneva. Mr. Ritter stated that Mr. Arbo reiterated to him that, before CIMA were informed, there should be an investigatory audit undertaken. Mr. Arbo indicated that his providing Mr. Ritter with the CIMA contact details and his reaching out to the attorneys concerning BDO's reporting obligations, was inconsistent with Mr. Ritter's contention that Mr. Arbo had told him to delay notifying anyone, including CIMA, until there was a fuller picture. Mr. Arbo says that it was Mr. Ritter who was driven to delay informing the Authorities because he wanted to first focus on being repaid by DS. Mr. Ritter said it was correct, when it was put to him in cross-examination, that from the time DS said he was going to repay him on 1 September that his:

> *"focus was on making sure he did repay."*

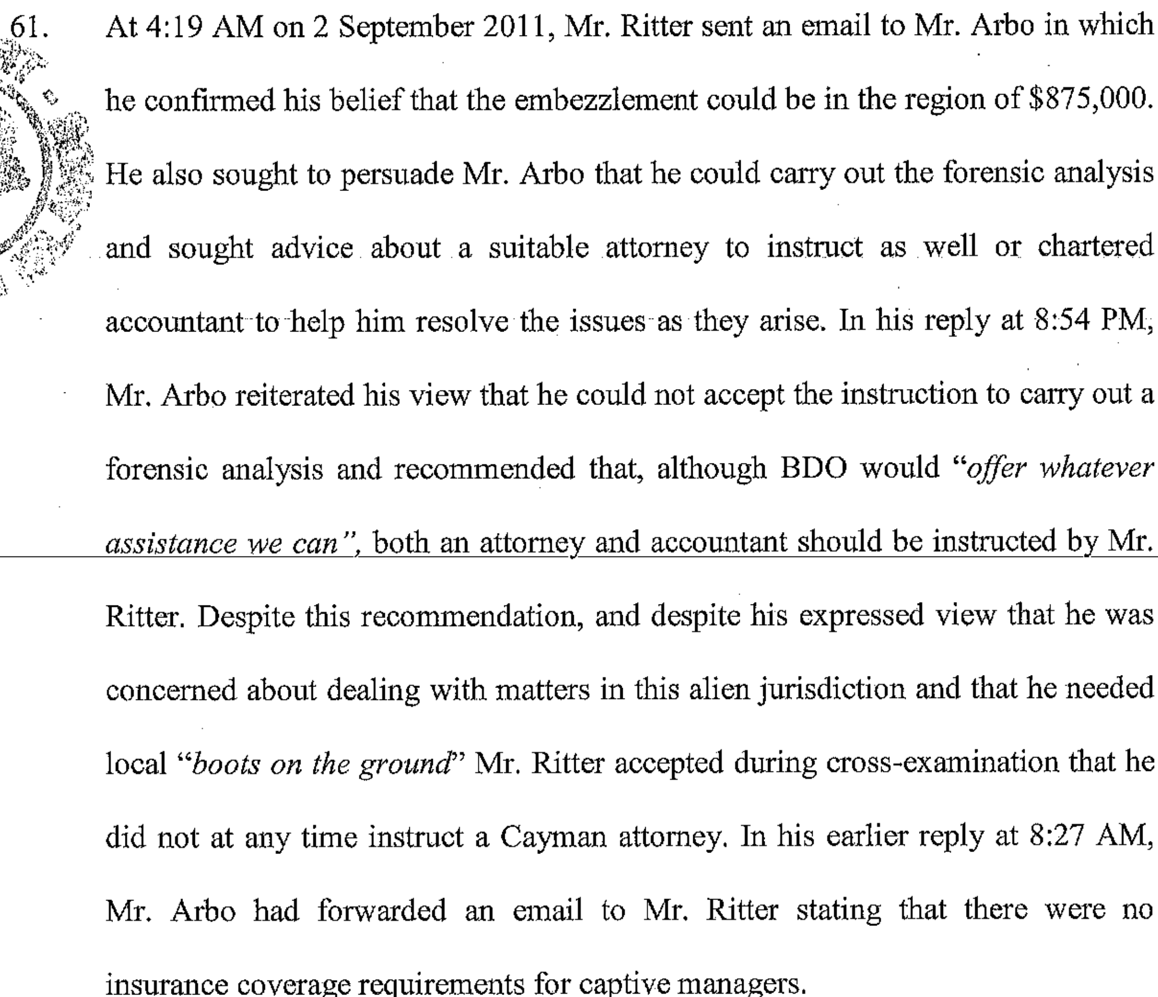
He also accepted when asked that his:

> *"objective was to secure full repayment from him as quickly as (he) could."*

This evidence tends to show that Mr. Ritter's deliberate silence was intentional and that its purpose was to ensure a smooth recovery of the funds from DS without any hindrance that would likely flow from reporting what he knew about the fraud.

60. At 4:49 PM Mr. Arbo indicated an email that he felt that, due to potential conflict issues relating to DS, the accounting assignment should be carried out by another accountancy firm instead of BDO and he made recommendations of other firms including Krys Global. At 5:09 PM Mr. Arbo emailed CIMA about the insurance coverage requirements for captive managers.

Background - Events from 2 September 2011 to December 2011 and the Duty to Report the Forgery/Fraud



61. At 4:19 AM on 2 September 2011, Mr. Ritter sent an email to Mr. Arbo in which he confirmed his belief that the embezzlement could be in the region of $875,000. He also sought to persuade Mr. Arbo that he could carry out the forensic analysis and sought advice about a suitable attorney to instruct as well or chartered accountant to help him resolve the issues as they arise. In his reply at 8:54 PM, Mr. Arbo reiterated his view that he could not accept the instruction to carry out a forensic analysis and recommended that, although BDO would "*offer whatever assistance we can*", both an attorney and accountant should be instructed by Mr. Ritter. Despite this recommendation, and despite his expressed view that he was concerned about dealing with matters in this alien jurisdiction and that he needed local "*boots on the ground*" Mr. Ritter accepted during cross-examination that he did not at any time instruct a Cayman attorney. In his earlier reply at 8:27 AM, Mr. Arbo had forwarded an email to Mr. Ritter stating that there were no insurance coverage requirements for captive managers.

62. Mr. Ritter telephoned Margot MacInnis at Krys Global on 2 September 2011. Mr. Ritter said that he informed her about his concerns with DS and about his dealings with the Geneva Account as well as the advice he said he had received from Mr. Arbo concerning the need for forensic investigation to be undertaken. At 9:05 AM Mr. Ritter told Mr. Arbo that he was retaining Krys Global.

63. Around the time that the Bank was processing the two fraudulent transfers involving Warco and Canadian Livestock outlined at paragraph 46 above, Cayman National Bank received a request from Monkton to transfer $75,000 to Mr. Ritter's personal account in the US.

64. BDO, being aware that Krys Global was being instructed in relation to the forensic analysis, contacted the Appleby Law Firm for legal advice concerning its obligations as Geneva's auditors to report the fraudulent conduct to CIMA and in relation to the filing of a SAR. On the same day Mr. Arbo informed Mr. Ritter by email that BDO had obtained the legal advice and that he had been advised that, as BDO had been made aware of a forgery, it was obliged to file a SAR.

65. Mr. Arbo sent a further email to Mr. Ritter at 4:29 PM informing him that, as BDO had received advice from Appleby, the firm could not be Geneva's attorneys due to conflict issues. He suggested that Mr. Ritter ask Krys Global about recommendations for suitable attorneys.

66. Mr. Ritter stated that he understood the content of the communications from BDO to mean that:

> "*BDO would be taking action and making a report about this to the appropriate Cayman Islands authorities.*"

He said that the veracity of his belief that BDO was taking immediate action on behalf of Geneva was later fortified when he received an invoice from them in October 2011 which included charges for their time spent dealing with the suspected fraud. Mr. Ritter stated that Mr. Arbo told him on 11 October 2011 that the disbursement included the preparation, by attorneys instructed by BDO, of the SAR dated 5 September 2011 and that this meant that BDO had taken the necessary actions and "*all required steps to comply with the letter of the law*" in September 2011, which he assumed to include being in contact with the Police or the Cayman Islands Authorities and "*notifying anyone who needed to be notified*".

67. On 4 September 2011 Mr. Ritter had made clear to Krys Global in his email to them that he was going to meet DS and "*focus on getting*" his money. Krys Global, clearly with one eye on due diligence issues, responded concerning the documents that should be obtained about the funds coming from DS. Ms. MacInnis wrote:

> "*...you should also request information to support the funds transfer to yourself - you will want a paper trail of the source of funds, so for instance keep e-mails where David Self explains them (i.e. as loans) or to the extent he explains in your meeting take a good*

note. One would expect he would transfer the funds through the company for legitimacy.
I am not a lawyer and cannot provide legal advice, to the extent you want to obtain legal advice in regard to these concerns you we [sic] *can provide you with some of the names of attorneys we've worked with."*

68. On 5 September 2011, after his arrival in the Cayman Islands, Mr. Ritter met with DS. Mr. Ritter had the presence of mind to heed the advice of Ms. MacInnis and record the meeting. DS showed him fax instructions on Monkton letterhead dated 1 September 2011 addressed to the Beckenham Branch of NatWest Bank in the UK with instructions to wire a single transfer of US$800,000 from the UK account to one of Mr. Ritter's accounts in the USA and a print out of the Branch's opening times. Despite this, DS told him that the repayment of the funds had already been sent to Monkton at the Cayman National Bank. Mr. Ritter said that DS told him that the funds were from family money in the UK and, when asked, indicated that did not come from other customers or clients. As highlighted by the Bank, despite the advice from Ms. MacInnis about the need for a paper trail, only this inadequate documentation was provided to Mr. Ritter. Mr. Ritter in his evidence agreed that this documentation was "*completely inconsistent*" with what Mr. Ritter said he had been told about the money coming from family money. He accepted in cross-examination that an honest person would need sufficient proof of the legitimate source of funds allowing the repayment of $875,000. It is also inconsistent with what actually happened with the three payments coming from

Cayman National Bank. Mr. Ritter accepts that he failed to ask for the documentation to verify the source of the funds.

69. Mr. Ritter has provided an agreed transcript of the digital recording of what was stated at that meeting. Mr. Ritter agreed during cross-examination that DS was a "*liar*", a "*fraudster*", a "*forger*" and a "*thief*" who had admitted to his actions to him on 1 September 2011. With this in mind, it is clear from the transcript and the evasive answers of DS that alarm bells should have been ringing about the source of the funds to be paid to Mr. Ritter as they may not be coming from family members. Mr. Ritter wrote in the record of the meeting that when he asked DS about insurance, Mr. Ritter stated:

> *"If I get the money, I don't care, but if I don't I care a lot."*

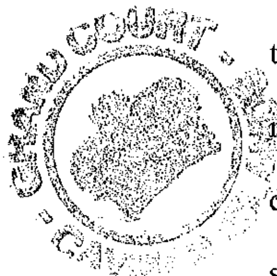
The transcript also records Mr. Ritter stating:

> *"...usually you can't insure yourself for criminal acts."*

This record shows an acknowledgment about the criminality of DS's conduct as well as a primary focus on getting the money back from DS.

70. The record of the meeting also reflects Mr. Ritter stating to DS:

> *"So I guess my only hope if your relatives don't come through is the bank. Because the instruments are forged they would have a duty."*



It is also clear that, as far back as 5 September 2011, Mr. Ritter was mentally able to strategise and was considering the fall-back option of seeking to be repaid by the Bank if the funds were not forthcoming from DS despite the fact that he had not, and did not for a long period of time, notify them of the forgery. He accepted during cross-examination that there could be no insurance claim in relation to the stolen funds, he having had the presence of mind to raise insurance issues in his very early discussions with Mr. Arbo, and that:

> "*the fall back (he) had in mind... if he didn't get (his) money was the bank.*"

In fact, during cross-examination of Mr. Skinner by Mr. Ritter's Counsel, it was made clear that Mr. Ritter's "*Plan A*" was to seek payment from DS via his family and that "*Plan B*" was "*to look to the bank.*" The fact that Mr. Ritter was even contemplating the possibility of seeking recovery from the Bank supports a contention that he had a duty to promptly report to the Bank to enable them to immediately try to mitigate any potential losses.

71. It is evident that Mr. Ritter had his suspicions about the source of the funds as he stated in an email sent on 6 September 2011 to Krys Global that:

> "*Obviously the miraculous relative loan has not materialized.*"

During cross-examination Mr. Ritter accepted that there was a real risk that the funds might be stolen from other customers' funds to repay him and that what DS was proposing was dubious. However, he later added when asked whether the he had some doubt about the source of the funds:

> *"Yes, but very little doubt. I thought it was family money, but I had some doubt."*

He then added that he wanted to believe that the money was coming from the family source and so he took DS at his word. He accepted in cross examination that, although a doubt existed about the source of the money when he received it, he felt that there was no need to tell the Bank about the fraud as he had been paid. Despite accepting the "*dubious*" nature of DS's proposals and the "*real risk*" that the funds he was to receive from DS might be stolen from other customers, Mr. Ritter deliberately chose not to warn the Bank by disclosing the forgery as he made a conscious decision to prioritise the unhindered receipt of the funds into his USA account.

72. On 5 September 2011 following his meeting with DS, Mr. Ritter also met with Ms. MacInnis and Mr. Krys, but he did not attend at or contact the Bank. The meeting was held in relation to them conducting a forensic investigation into the transactions on the Geneva Account. Although aware that Krys Global were being retained to first carry out a forensic investigation, Mr. Ritter said that he felt that this was to be only the first phase of their activity and that their involvement would be more expansive and to an extent, as with BDO, he relied upon the content of their invoices to him to support such a view. Mr. Krys informed the Court that Mr. Ritter did not show them any documentation at the meeting to support the source of the funds coming from DS, nor did he express any doubts to them about whether the money was actually coming from family members.

73. From the content of the later 27 August 2012 letter from Krys Global to the Bank and due to Mr. Krys's oral evidence that he had no recollection of Mr. Ritter sharing with him the fact DS had told him about forging his signatures on the transfers to enable him to remove the funds, it is clear that Mr. Ritter was not forthright with them about the forgery. For Mr. Ritter to seek to place any reliance on any advice he received from Krys, who were accountants and not attorneys and so could not advise about the legal issues resulting from a forgery[18], it would have required him to provide full details to them, so that they might have proffered any advice in an informed manner. I carefully note that Mr. Ritter contends that Krys's recollection of the meeting is *"so poor"* and that "*most certainly*" he had told the "*Krys Global team*" about everything DS had said to him during the phone calls of 1 and 2 September 2011 as well as reporting the content of his meeting with DS on 5 September 2011. I also note that, in an email sent to Ms McInnis sent on 6 September 2011, Mr. Mr. Ritter refers to the Geneva Account "*from which the embezzlement occurs",* but in their email exchanges there is no detail from him about what form that took or any reference to forgery. He states that Krys's memory may be poor because of "*professional detachment.*" On the other hand, despite him also claiming that the nature his interaction and sharing of information with the Bank had been hindered by the shock of the disclosure to him by DS about the forgery[19], Mr. Ritter contends that his powers of recollection should be preferred as he was "*experiencing uniquely distressing*

[18] Ms. MacInnis having made clear in an email to Mr. Ritter sent on 4 September 2011 that she could not provide legal advice and that she could provide details of attorneys – see paragraph 67 herein.
[19] At paragraph 168 of his witness statement dated 23 November 2011 confirmed that he was still "*very shocked and upset by what he had discovered...*"

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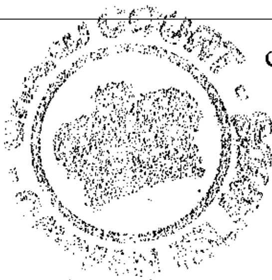
circumstances" of him losing US$875,000. When one considers the 27 August 2012 letter from Krys Global to the Bank in which no mention of the admission of forgery is made, it appears more consistent with the evidence of Mr. Krys that nothing was said by Mr. Ritter concerning the forgery.

74. Mr. Ritter said in his first witness statement and in his oral evidence that at the meeting, Mr. Krys gave him some hope that he would be reimbursed with funds coming from DS's relatives:



> "*as the word on the island was that (DS's) business was derived from family money*" in England.

Mr. Ritter said that this reinforced his belief that such money was lawfully funding the transfers to his US account mentioned in paragraph 47 above. In his evidence in chief Mr. Krys forcefully denies ever having made this comment and stated that he did not know DS or his family and he would not have spoken to anyone else about DS prior to the meeting, so he would not have known about his family situation. He was not asked about this in cross-examination. I prefer Mr. Krys's unchallenged evidence to that given by Mr. Ritter and, even if I am wrong, it does not minimise the fact that DS accepted in his oral evidence that he had real doubts about the source of the funds.

75. Mr. Ritter said he was aware of Mr. Krys being a former Director of CIMA and that, as he felt CIMA had been informed in early September 2011 by BDO and Krys Global about the fraud, he:

> "*pictured that officials in black jackets would be entering Monkton offices, and/or the bank itself and telling anyone present to step away from the computers*".

Although not accepted by Mr. Arbo, Mr. Ritter stated in his second written statement that Mr. Arbo told him, on 5 September 2011 that the police:

> "*would have to look at the bank records to verify the embezzlement.*"

It appeared that Mr. Ritter mistakenly felt that this belief held by him put the obligation on others and excused him from any obligation that he may have had to notify the Bank in specific terms about the fact that there had been a forgery and fraudulent activities on the Geneva Account and about the detail he knew about that. That said, Mr. Ritter accepted in his statement signed on 23 November 2016 that:

> "*The position of (the Bank) and who would be responsible for contacting the Bank with dealing with the Bank was never specifically discussed at any point during*" the meeting on 5 September 2011.

Mr. Krys indicated in his statement signed on 23 November 2016 that:

> "*From my review of the email correspondence between members of the Krys Global team and Mr. Ritter, the signed engagement letter, the invoices rendered and my recollection of the discussions around September 2011, neither I (nor anyone else in the Krys Global team) gave any assurances that we would take all necessary steps to notify CIMA, the relevant authorities and any*

other party who was required to be notified of the fraud (as pleaded in paragraphs 102 and 102A of the Amended Statement of Claim). In fact as appears from the emails, it is Mr. Mr. Ritter who is asking us questions such as whether there is anything he "should do with the bank" as he had "not spoken with them at all on this matter". Neither the email correspondence nor the engagement letter states we will undertake such steps. In fact, the engagement letter stipulates that Mr. Mr. Ritter acknowledges that we accept no responsibility for directing the Company's affairs, the sole responsibility for which remains with the directors and management of the Company (ie Mr. Mr. Ritter).... Further, Krys Global would not have been in a position to make any statement or conclusion as to whether there was fraud until the conclusion of the forensic analysis and production of the draft report in late November."

76. In the abovementioned engagement letter, which Mr. Ritter signed on 22 September 2011, Krys Global made clear that they had been asked by Mr. Ritter to perform a forensic review of the bank statements for the relevant period to identify any regular withdrawals or transfers. They added that they did so wholly reliant upon the information provided to them by the Directors of Geneva without third-party verification. In the letter, as stated above by Mr. Krys, Krys Global also made patently clear that it accepted no responsibility for directing the company's affairs and that the sole responsibility for that remained with the Directors and management of the company. It is the terms of that letter that governed the boundaries of the authority or mandate given to Krys Global, and

this did not include a usurpation of the powers, duties and obligations of Geneva's Directors.

77. Mr. Krys also indicated that the wording in the invoices sent to Mr. Ritter did not mean, and could not have been interpreted to mean, that Krys Global would be taking all necessary steps to notify CIMA, the Authorities and any other party of the fraud. He reiterated these assurances were never given to Mr. Ritter and that he had no reason from the content of their communications for saying that such assurances were given. I found Mr. Krys to be a forthright witness and his evidence was consistent on these issues.

78. Ms. MacInnis, who had not been provided with any verifying documents and was unaware of Mr. Ritter's concerns about whether DS was really getting the repayment funds from his family and not from other clients, made clear in her email on 6 September in reply to a question from Mr. Ritter as to whether there was anything that he should do with the Bank that:

> "*In terms of notifying the bank this should be considered once* *you've taken a decision*[20]*' which I appreciate is influenced on whether you get the money back or not.*"

79. It appears that Mr. Ritter wrongly relies upon the above email exchange he had with Ms. MacInnis as an excuse for him not notifying the Bank about his knowledge of DS's fraudulent conduct. In fact his question about whether there is

[20] My emphasis by underlining.

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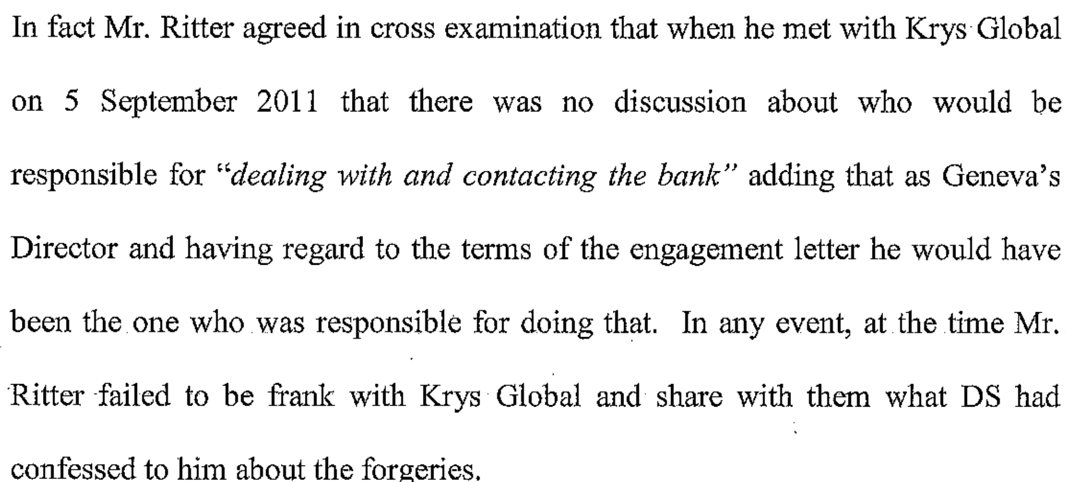
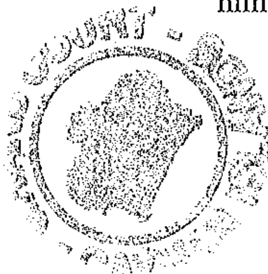
anything that he should do with the Bank shows that he was then accepting that, he had "*not spoken to (the Bank) at all on this matter*" and acknowledging that he may be obliged to do some things to do with the Bank.

80. I prefer the evidence of Mr. Krys to Mr. Ritter's and I am satisfied that Krys Global did not give the impression that, as a part of their engagement by Mr. Ritter to perform forensic duties, they would be notifying the Bank of the forgery. In fact Mr. Ritter agreed in cross examination that when he met with Krys Global on 5 September 2011 that there was no discussion about who would be responsible for "*dealing with and contacting the bank*" adding that as Geneva's Director and having regard to the terms of the engagement letter he would have been the one who was responsible for doing that. In any event, at the time Mr. Ritter failed to be frank with Krys Global and share with them what DS had confessed to him about the forgeries.



81. Mr. Arbo stated that on 6 September 2011 Mr. Ritter called him and informed him that matter has been progressing positively. In his oral evidence Mr. Arbo said that Mr. Ritter did not express any doubt or any concerns to him about the repayment of the funds. Mr. Arbo said that he did not remember Mr. Ritter ever bringing up any doubts about the family money story, nor did he show him any documents he had received in support of that story. If BDO was to take on the wider role involving notification to the Bank and communication on Geneva's behalf to the Authorities which Mr. Ritter wrongly believed they had, BDO would

have rightly expected greater frankness from him. Mr. Arbo shared this detail in an email to Appleby, BDO's attorneys, and added that Mr. Ritter was requesting him to:



> "*delay, as much as possible/appropriate, the filing of the SAR for a few days as he did not want to "muddy the waters" in terms of coming to resolution with (DS).*"

This email written by Mr. Arbo shortly after his discussions with Mr. Ritter is highly inconsistent with Mr. Ritter's evidence in his second witness statement when he swore that he:

> "*could categorically state that I never asked BDO to delay (the SAR).*"

Mr. Arbo in an earlier email to Appleby's on that day had told them that:

> "*...(Mr. Ritter) seems to want to delay notifying the police and CIMA until he gets a better sense whether (DS) might be coming through with the money he promised to repay.*"

Mr. Arbo mentioned at paragraph 10 of his statement sworn on 21 November 2016 that:

> "*he recalled Mr. Ritter saying he was concerned about compromising his efforts to get his money back.*"

These are all consistent with a deliberate decision being made by Mr. Ritter to delay notifying others of the forgery, at the very least until the funds removed

from the Geneva Account were recovered into his personal USA account from DS.

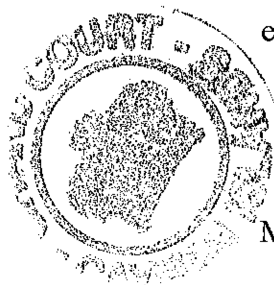
82. Mr. Arbo told BDO's attorneys that Mr. Ritter had informed him that he had already received US$75,000 from DS's company's account and the DS was working toward getting the rest from family members. This is consistent with the Bank's case that Mr. Ritter was primarily concentrating on recovering his monies from DS, over and above any obligations to report the admitted forgery to the Bank or to the Authorities.

83. Mr. Arbo also informed the attorneys that he had told Mr. Ritter that BDO were obliged to file an SAR and that he was considering what the obligations were in relation to reporting to CIMA. BDO's attorneys filed the SAR with the Financial Reporting Authority on 6 September 2011.

84. The funds stolen by DS from Warco and Canadian Livestock were credited into Monkton's account at Cayman National Bank at 11:55 AM on 6 September 2011. DS instructed the Bank to transfer US$225,000 and US$575,000 to Mr. Ritter's personal account at HSBC in the USA. At 2:00 PM DS informed Mr. Ritter that the money would be coming in three different batches and Mr. Ritter was given two Cayman National Bank receipts for the two above payments.

85. Mr. Ritter received the US$75,000 and the US$225,000 later on 6 September 2011. He received the final payment, US$575,000 on 7 September 2011.

86. Thereafter, when Mr. Ritter informed Krys Global that he would sign their engagement letter he added that the:

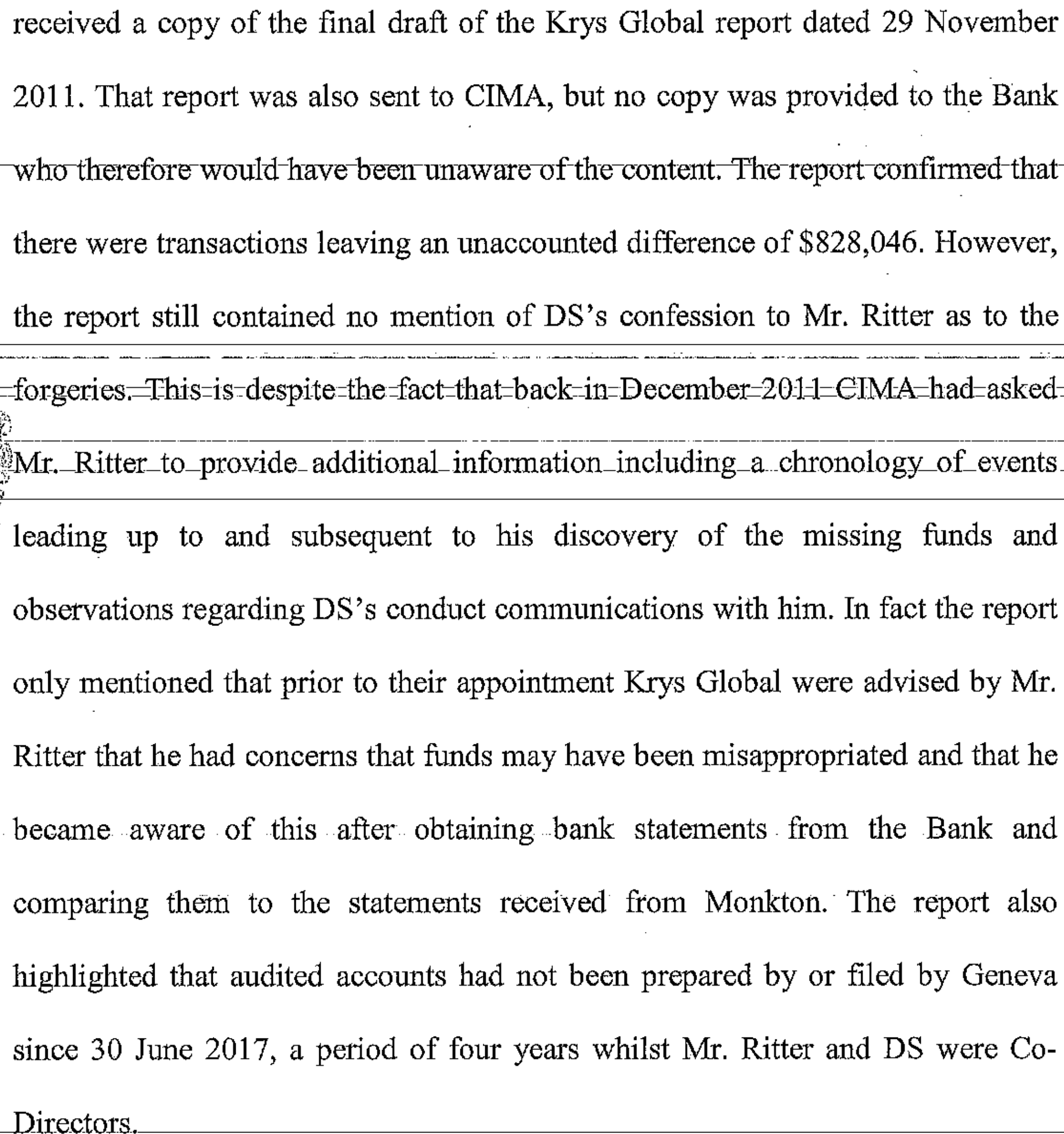


> "*USD800,000 has been received. Hard to believe.*"

Mr. Ritter states that although he had recovered all of Geneva's funds, as a "*responsible and concerned citizen*", he continued with the appointment of Krys Global to conduct a forensic investigation so that CIMA could be made aware of the events in an informed manner.

87. On 16 November 2011, following receipt of the first draft report from Krys Global which had wrongly analysed the fraudulent bank statements produced by DS, Mr. Ritter wrote to the Bank requesting reprints of the statements on the Geneva Account to cover the period from its opening until 31 October 2011. Again, although he had known about the forgery for over two months, he failed to make any mention to the Bank of the forgery. When he received those statements Mr. Ritter would have seen that the balance which illustrated that the Bank, in the absence of Mr. Ritter sharing with them what he had known about the forgeries since 1 September 2011, were treating the debits as being genuine transactions.

88. Mr. Ritter stated that he had been notified by Krys Global that they had informed CIMA of the fraud in November 2011 and that at the end of the month he



received a copy of the final draft of the Krys Global report dated 29 November 2011. That report was also sent to CIMA, but no copy was provided to the Bank who therefore would have been unaware of the content. The report confirmed that there were transactions leaving an unaccounted difference of $828,046. However, the report still contained no mention of DS's confession to Mr. Ritter as to the forgeries. This is despite the fact that back in December 2011 CIMA had asked Mr. Ritter to provide additional information including a chronology of events leading up to and subsequent to his discovery of the missing funds and observations regarding DS's conduct communications with him. In fact the report only mentioned that prior to their appointment Krys Global were advised by Mr. Ritter that he had concerns that funds may have been misappropriated and that he became aware of this after obtaining bank statements from the Bank and comparing them to the statements received from Monkton. The report also highlighted that audited accounts had not been prepared by or filed by Geneva since 30 June 2017, a period of four years whilst Mr. Ritter and DS were Co-Directors.

89. On 1 December 2011 a conference call took place involving Mr. Ritter, Krys Global and CIMA concerning the report and Geneva. Even after receipt of the final forensic report from Krys Global dated 18 January 2012[21], Mr. Ritter still failed to notify the Bank of the forgeries.

[21] A copy of the report was provided to CIMA on or around 25 January 2012.

90. I accept that until the earliest late August 2011 or more likely 1 September 2011 Mr. Ritter was not aware of these fraudulent transactions, especially as until August 2011, DS had been providing him with false bank statements for the Geneva Account which contained inaccurate balances and did not contain details of the fraudulent transactions. It is clear that Mr. Ritter did have a duty to promptly share with the Bank in clear and precise terms what he knew about the forgeries after the admissions DS made to him. Mr. Ritter suggests that he should not be criticised for what happened on 1 September 2011 and thereafter as he acted *"as any honest and reasonable man"* would have done under the circumstances. It is submitted that his approach was understandable, as he says he immediately took action to recover the funds from DS and, as he was unfamiliar with the laws and regulatory requirements in this jurisdiction, he contends that he appropriately sought expert advice and guidance from BDO, Geneva's auditors, concerning his duties to report the fraud and what interaction he should have with the Authorities. From his evidence it is clear that Mr. Ritter seeks to justify his longstanding failure to notify the Bank by wrongly blaming others.

91. Both Mr. Krys and Mr. Arbo, although both engaged in the past by Geneva, were entitled to give evidence in these proceedings to present their versions of events which are in conflict with that given by Mr. Ritter rather than leave the Court to make a decision on incomplete evidence. I note that Mr. Arbo was called as a witness for the Bank and that Mr. Ritter chose not to call him as a witness. This may well be because his evidence undermines parts of Mr. Ritter's evidence,

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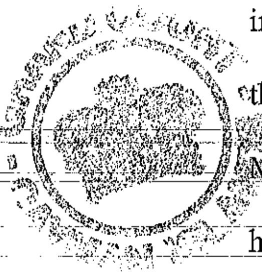
especially in relation to the reasons for Mr. Ritter's failure to inform the Bank of the forgery. What I have already noted in Mr. Arbo's evidence that there was no discussion about notifying the Bank is consistent with Mr. Ritter's oral evidence in chief when he stated that they discussed informing CIMA and the police about the fraud, but he did not discuss telling the Bank and that the topic never came up. Mr. Ritter also confirmed in cross-examination that he did not ask BDO if they had notified everyone who needed to be notified of the fraud.



92. It is understandable that Mr. Ritter put faith in BDO to perform their duties, but only duties that relate to their capacity as Geneva's auditors[22]. I accept that, especially after the funds from DS had been received into his US account, Mr. Ritter was content for the Authorities to be notified and he did not at that stage seek to cover up for or protect DS. BDO appropriately sought legal advice as to what their legal reporting obligations as auditors were in the circumstances and these were proceeds of crime obligations which did not include a requirement for them to notify the Bank. The email from Mr. Arbo on 11 October 2011 in response to Mr. Ritter's query about the claim by BDO for fees incurred by Appleby in advising them supports and does not detract from this contention. It makes clear that the duties are as Geneva's auditors and not acting in a wider capacity for Geneva.

93. Mr. Ritter's further excuse for not reporting being that he did not want to tip off the Bank as a member of staff may have been assisting DS is also without merit

[22] My emphasis by underlining.

and is to a degree inconsistent with his view that he made the Bank aware on 1 September 2011 of serious irregularities on the Geneva Account. It is consistent with a contention that he was deliberately withholding disclosure of the forgery to the Bank. I note with great interest that in the letter from his attorneys on 14 May 2015 at paragraph 55 they state:

> *"Mr. Ritter's first instinct was that (DS) must have had inside help from someone at Butterfield. He did not therefore contact the bank at this time, preferring to go directly to the Cayman authorities."*

Mr. Ritter later reiterated in his statement sworn on 26 November 2016, when seeking to justify his failure to notify the Bank about the DS's conduct, that he:

> "*had been concerned about whether someone at Butterfield could have assisted (DS) and had been uncertain about whether I should say anything to them until the police and CIMA took action.*"

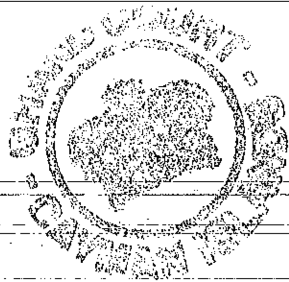
This evidence is inconsistent with what Mr. Ritter said in his statement that he had given:

> *"no particular thought at the time[23] about whether (the Bank) should or would be notified and by whom"[24]*.

I am satisfied on the evidence that Mr. Ritter made a conscious decision not to tell the Bank at that time as he feared that this might result create problems in receiving the funds DS promised to transfer into his personal account in the USA. He further stated that this concern about staff members being directly involved in the fraud is why he instructed DS to return the funds to his personal account

[23] "*at the time*" being - the 7 September 2011.
[24] Paragraph 187 of Mr. Ritter's statement sworn on 23 November 2016.

rather than to the Bank. Such a belief, if it genuinely existed at the time, was not well founded and even if it was, should have amounted to a greater reason for Mr. Ritter, as a conscientious corporate customer of the Bank who was "*acting as a responsible and concerned citizen*[25]", to ensure that the Bank was aware of the events. As set out in paragraph 50 herein, it is clear that this allegation is not being pursued by the Plaintiffs.



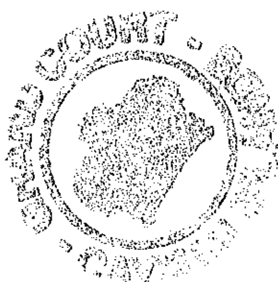
94. Mr. Ritter is an experienced businessman operating in the financial sector and invariably having to deal with banks as he has been launching medical ventures and selling them to public companies since 1982. This is a view shared by Mr. Krys, the Executive Chairman of Krys Global and former Head of Enforcement for CIMA, which is derived from his dealings with Mr. Ritter and his own knowledge of the complexities of the insurance industry. In this regard, I note the sentiments expressed in the case of ***Ewing v. Dominion Bank*** [1904] 35 SCR 133, a case in which estoppel was considered in the absence of a contractual relationship of banker and customer. A majority of the Supreme Court of Canada held that Ewing & Co., whose name had been forged as makers of a promissory note and who had received notice from the bank that it held the note and that payment should be provided at the bank on due date, were estopped by their silence, while they attempted to settle the matter with the forger, from setting up the forgery against the bank, because they could have saved the bank from at least part of its loss if they had promptly shared their knowledge of the forgery with it. In ***Ewing*** Girouard J. opined at p.143:

> "*Speaking for myself, I cannot satisfy my mind that when a business man, familiar with banking operations, their meaning and scope, is*

[25] paragraph 187 of Mr. Ritter's statement sworn on 23 November 2016

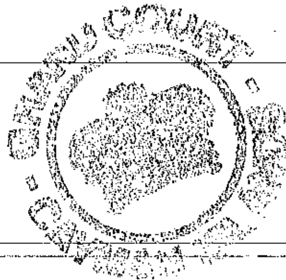
> *informed, according to banking usages, that his name is being used as maker of a note in a bank, evidently for cash credit either already made or to be made, he is under no obligation to reply promptly, at least within a reasonable time, that it is used without his authority, or even that it is a forgery.*"

Then at pages 151-152 in ***Ewing*** Davies J., referring to the statement concerning estoppel made by Parke B. in ***Freeman v Cooke*** (1848) 2 Ex 654, 663:[26]



> "*Both parties profess to rely upon this rule in this case though I cannot find that any one of the limitations mentioned in it express or suggest the existence of the relationship of banker and customer or similar relationship as necessary to create the duty the neglect of which imposes the liability. It speaks of a neglect of duty cast upon a person by the usage of trade or otherwise to disclose the truth. I fail to appreciate the argument which would confine this duty to cases where such relationships already exist as those between banker and customer or seller and buyer. It does seem to me that in a country like Canada where such a large proportion of its business is carried on by credit evidenced by drafts and notes which are discounted by one or other of the chartered banks of the country the usages of trade which create the duty apply to all persons engaged in trade who are notified of the holding by one of these banks of a note or draft professing to be theirs. I cannot believe that such a duty would exist as between the bank and Ewing & Co. if the latter was a regular customer of the former and would not exist otherwise. It seems to me the duty naturally arises out of the usages of trade as they exist. Banks do not confine their discounts to those of their own customers only. It is known to every one engaged in trade that a large part of the bank's business consists in the discounting for its customers of*

[26] See paragraphs 136 and 138 below.



commercial paper professing to be that of other merchants or traders. And when a business man receives such a notice from a bank as Ewing & Co. did in this case, if such notice contains information of a forgery and fraud being practised upon a bank, in the unauthorized use of the name of the person or persons notified, the latter are bound by every principle of justice and right dealing between man and man, and in accordance with the usages of trade, within reasonable time to give the bank notice of the fraud.[27] *Any other rule would seem to me to be fraught with grave danger; would generate want of confidence in the ordinary business relations of life and would offer a premium upon gross business negligence.*"

95. Mr. Ritter could have had no doubt using his common sense that he had a duty to inform and warn the Bank immediately, especially as DS had just admitted to him that there had been forgeries made by him and fraudulent activities on the Geneva Account. He could also, at the same time, have cautioned the Bank that the details were not fully known as a forensic accounting was to be carried out. Mr. Ritter chose not to do so and he wrongly seeks to shift the blame for that on Mr. Arbo, BDO, Krys Global and CIMA.

96. I accept the evidence of Mr. Arbo that reporting the fraud to the Bank was not the responsibility of Geneva's auditors who had, on 1 September 2011, just been invited by Mr. Ritter to carry out a forensic review of transactions during the relevant period. I accept Mr. Arbo's evidence that he did not encourage Mr. Ritter

[27] My emphasis by underlining. - See the Privy Council decision in the more recent case of ***Tai Hing*** (at paragraph 139 herein) where the requirement to report is stricter, as it is to be done as soon as becoming aware of the fraud rather than doing so within a reasonable time.

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to not inform the Bank and that there was no discussion about the reporting obligations to the Bank. If I am wrong in reaching that conclusion or if Mr. Ritter genuinely believed BDO was going to report, when it became clear that BDO felt conflicted and were no longer advising him and that the Bank had not been informed, he had a responsibility to report.

97. Mr. Ritter's contention that he had discharged this duty to report as he believed that the content of his telephone conversations with the Bank employees on 1 September 2011 amounted to putting the Bank on notice is misconceived. Mr. Ritter expressing the incorrect 'belief' the Bank would become aware of the fraud as DS would "*be arrested, quite literally, within minutes or hours*" which would "*freeze everything up*" again is not a justifiable excuse for not informing the Bank himself, and when it became evident that DS was not arrested at the time the excuse had even less merit.

98. Mr. Ritter's evidence is not convincing and has the character of someone, after the event, searching for and creating excuses for deliberately not doing what he clearly should have done at the time, namely immediately report the detail of the fraudulent activity on the Geneva Account to the Bank. Although he did not accept the suggestions that "*he intended to keep the bank in the dark to stop them taking actions which (he) could not control which might affect (DS) paying him*" and that he "*wanted to protect (DS's) ability to repay*" him, it is conceded by Mr. Ritter that his primary focus was to ensure that the funds were recovered from DS

and this meant receiving them from DS into his US account. Mr. Ritter admitted that he was concerned that DS could be arrested before the wires from DS to his account had been processed and this was confirmed by Mr. Arbo during cross examination. This, coupled with the evidence of Mr. Arbo, shows that Mr. Ritter acted deliberately in withholding the information and that his silence was intentional. Even after receiving the funds in the account and despite having concerns about the source of the funds he still deliberately failed to inform the Bank, and this was consistent with his Plan A. It was only when his Plan A began to fall apart, due to the then imminent Texas proceedings, after he decided to move on to Plan B which involved him coming against the Bank for recovery, that adequate disclosure about the existence and detail of the forgery was given.

Background – The Events of February and March 2012 – Appointment of Monkton Controllers

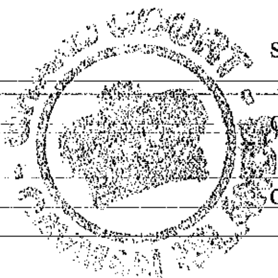
99. On 14 February 2012 the Bank were notified that CIMA had appointed Gordon MacRae and Eleanor Fisher of Zolfo Cooper as Controllers of Monkton "("the Controllers"). On 14 February 2012 the Controllers made a written request to the Bank that no instructions issued by Monkton should be processed. It is conceded by Mr. Ritter during cross-examination that there is nothing in the letter which specifically states there had been a forgery on the Geneva Account. Although the content of the written request of the Controllers did not notify the Bank that a fraud had been committed against Geneva or that DS admitted forging Mr. Ritter's signature, Mr. Ritter contends that the notice, request and the receipt of the later Freezing Order constituted notice to the Bank of the forgery on the

Geneva Account. The Bank, until these proceedings, was not provided with any of the reports made by the Controllers which contained reliable information about DS's conduct.

100. From the Controllers' investigations it was evident that Geneva was not the only client of Monkton who have been defrauded by DS. On 16 February 2012 the Bank was informed by the Controllers' attorneys that DS's assets had been frozen by the Court and they were served with that order on the following day. There is nothing in the Freezing Order made by Foster J. or in any of the correspondence in February relating to the order that refers to any forgery or fraud on the Geneva Account. In fact, Mr. Ritter conceded during cross-examination that there was nothing in the documents or correspondence produced in February 2012 that notified the Bank of fraud and forgery on the Geneva Account and that the arrest itself did not amount to such notification.

101. On 17 February 2012 DS was arrested and, again, Mr. Ritter contends that this should have put the Bank on notice of the forgery on the Geneva Account. I note, when considering the Plaintiffs' submissions that disclosure by Mr. Ritter to the Bank in September would have resulted in the Authorities being notified and in the Controllers or the JOL's taking prompt action that would have limited recovery by the Bank in any proceedings if brought in relation to DS's assets at the time, that DS's arrest took place five months after the filing of SAR containing detail about DS's admissions which one would have expected to have

been drawn to the Financial Crime Units attention. It does not appear that the details of the arrest were widely reported or outlined that it was related to impropriety on the Geneva Account. In fact the news article dealing with the sentence handed down in December 2012 outlined that the thefts that were the subject of the charges occurred between 12 January 2011 and 24 January 2012, so outside the period when the forgeries relevant to the proceedings before me occurred.



102. I accept Mr. Skinner's evidence that these events in February 2012 did not draw the Bank's attention to specific forgery on the Geneva Account, but were an indication that some wrongdoing had taken place in relation to some of Monkton's managed captives. The Bank responded appropriately to the request of the Controllers and the order of the Court. Receipt of the request did not require them to conduct a wide-ranging investigation into forgery for fraud on all the accounts with a connection to Monkton, including the Geneva Account. Of course, if Mr. Ritter had shared all of his knowledge with the Bank about the forgeries, the Bank would not have to embark on the speculative exercise that Mr. Ritter believes they should have carried out in the circumstances.

103. On 21 February 2012 DS swore an affidavit exhibiting a list of his worldwide assets. The Bank submits that, from the date of his confession to Mr. Ritter on 1 September 2011, DS must have been aware that he could be arrested or be subject to civil proceedings so by 21 February 2012 he may have siphoned off his assets.

104. On 23 February 2012 Mr. Ritter, in response to the request for the detail outlined in paragraph 88 above, wrote to the Head of the Insurance Division at CIMA. He informed him that DS had told him that he had borrowed the money and that he had been able to access it by falsely signing Mr. Ritter's name. He also told CIMA that DS had stated that he would be repaid from funds from his relatives in the UK, although he did not share the doubts that he has told the Court he had about this source of funding. In this communication, as well as during the conference call on 1 December 2011, it is clear that Mr. Ritter was not as frank with CIMA about his concerns about DS and the source of the funds as he should have been. The Bank did not see this letter until disclosure was given in these proceedings. By 23 February 2012, Mr. Ritter had still failed to inform the Bank about the forgeries and DS's admissions about the same, and the Bank did not see the letter to CIMA until these proceedings.

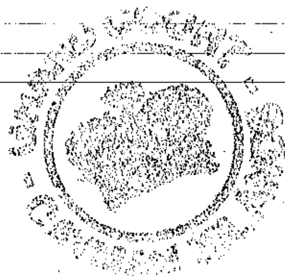
105. On 8 March 2012 the Controllers obtained Default Judgment with damages to be assessed against DS. Mr. Skinner states that, if Mr. Ritter had informed the Bank of the forgeries when he became aware of them on 1 September 2011, it is very likely that it would have obtained judgment against DS by 1 November 2011, if not before.

106. It appears that by 26 March 2012 the Controllers had entered into a Settlement Agreement with DS, under which he granted a power of attorney for the sale of his worldwide assets. On the same day the Controllers instructed real estate agents

to list for sale DS's Cayman Islands condominium property located on Seven Mile Beach in the Cayman Islands.

Background – April 2012 to May 2012 - Monkton Joint Voluntary Liquidation & Official Liquidation - Geneva Joint Voluntary Liquidation

107. On 2 April 2012, by a shareholder's resolution, Monkton was placed into Joint Voluntary Liquidation. On 12 April 2012 the Bank was requested to put a freeze on the Warco and the Canadian Livestock accounts following notification from the attorneys for the liquidators that DS had admitted the unauthorised transfers from them. On 17 April 2012 the Liquidators instructed real estate agents to list DS's Florida property for sale.



108. On 26 April 2012 Monkton was placed into official liquidation by supervision order of Cresswell J.

109. On 30 April 2012 Geneva was placed into voluntary liquidation and appointed Mr. Krys and Ms. MacInnis as its Joint Voluntary Liquidators.

Background – May 2012 to April 2013 - The Texas Proceedings - Recovery by the Joint Liquidators of Monkton – Default Judgments against DS

110. On 15 May 2012 the Bank was informed by Krys Global in writing that Joint Voluntary Liquidators had been appointed to Geneva. The Liquidators signed the banking forms, changing the authorised signatories on the Geneva Account on 31 May 2012. In the correspondence Krys Global did not inform the Bank about the admitted forgeries by DS on the Geneva Account.

111. On 14 June 2012 the Monkton Liquidators' US Counsel served Notice of Claim against Mr. Ritter in Texas for the recovery of $875,000 paid to him fraudulently from the accounts of other captive clients of Monkton.

112. DS's Seven Mile Beach Condominium was sold on 20 June 2012 and 50% of the US$172,000 proceeds of sale, after the mortgage was discharged, the costs of sale were met and the strata dues paid, was provided to DS's wife and the remaining 50% totalling US$86,000 was paid into the liquidation estate.

113. The Florida property was sold on 4 December 2012 for US$85,000 and, after deductions, $61,004 was paid into the liquidation estate. US$7,113 was paid into the liquidation estate from the sale of Class A shares in Greenlight Capital Re and US$5,883 was also paid in from the sale of a Ford Motor vehicle.

114. There is some inconsistency in the Liquidators' reports, with two figures being given for the total realisable assets namely, US$159,950 and US$154,822. Monkton's Liquidators highlight that DS told them that he had sent US$200,000 to Maria Henry (DS's sister in law), but they did not seek to investigate or recover that payment. It is clear from their report that the absence of funding resulted in the limitation on the depth of their tracing enquiries, including in relation to the purported $200,000 gift from DS to his sister-in-law. The Bank contends that, having regard to the US$875,000 DS received from the defrauding and taking into account the recovered balance of around $160,000 and the abovementioned

$200,000, DS must have had other tangible assets as he could not have used up the US$515,000 balance on only luxury travel, university fees for family members and lifestyle expenses between 28 December 2008 and February 2012. Mr. Skinner stated that the Bank would have pursued a greater investigation into DS's financial affairs than the one that the Liquidators did, in particular into the US$200,000 payment to Ms. Henry. Despite the submissions by the Bank about how DS may have used funds between September 2011 and February 2012, there is insufficient evidence to make a finding that there were additional funds, but it is evident that the late knowledge of the forgeries prevented them having the opportunity to make a timely and thorough investigation into DS's finances. Accordingly, I am only able to ascertain with any certainty that DS's realisable assets available to meet creditors' claims were in the region of US$160,000 during the relevant period of time.

115. The Bank claims that if it had been informed about the forgeries on 1 September 2011 it could have brought legal proceedings at a time when DS still had assets of, at the very least, US$160,000, but probably more if a more thorough investigation to the one undertaken by the Liquidators had been carried out. Mr. Skinner's evidence was that it would take one to two months (to the beginning of November 2011, well before the completion of the Krys Global Report which was sent to CIMA leading to the appointment of the Monkton Controllers in February 2012) to obtain legal advice and to act. It is contended that this is a realistic time frame, especially if Mr. Ritter had shared his knowledge about the detail/amount

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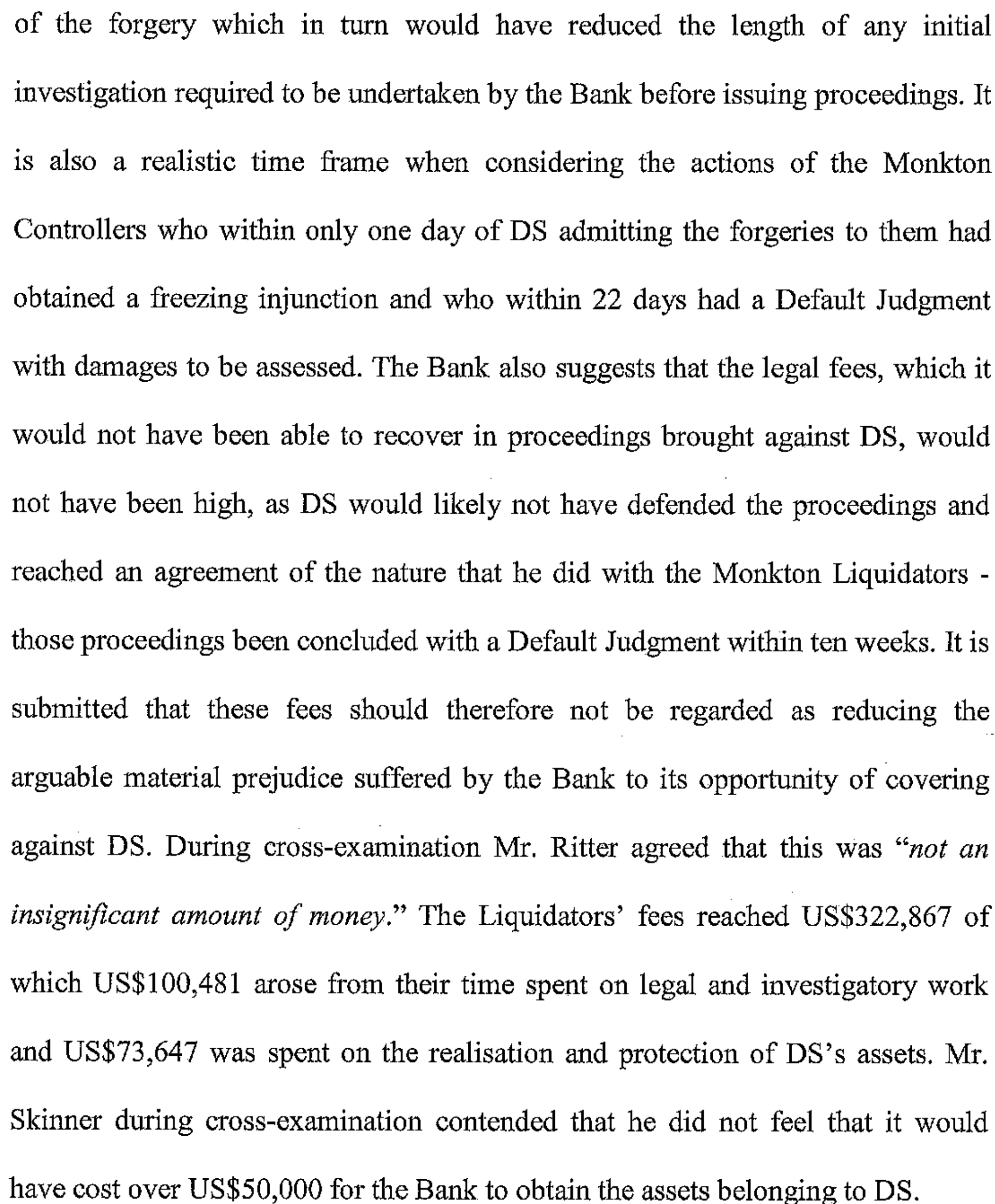


of the forgery which in turn would have reduced the length of any initial investigation required to be undertaken by the Bank before issuing proceedings. It is also a realistic time frame when considering the actions of the Monkton Controllers who within only one day of DS admitting the forgeries to them had obtained a freezing injunction and who within 22 days had a Default Judgment with damages to be assessed. The Bank also suggests that the legal fees, which it would not have been able to recover in proceedings brought against DS, would not have been high, as DS would likely not have defended the proceedings and reached an agreement of the nature that he did with the Monkton Liquidators - those proceedings been concluded with a Default Judgment within ten weeks. It is submitted that these fees should therefore not be regarded as reducing the arguable material prejudice suffered by the Bank to its opportunity of covering against DS. During cross-examination Mr. Ritter agreed that this was "*not an insignificant amount of money*." The Liquidators' fees reached US$322,867 of which US$100,481 arose from their time spent on legal and investigatory work and US$73,647 was spent on the realisation and protection of DS's assets. Mr. Skinner during cross-examination contended that he did not feel that it would have cost over US$50,000 for the Bank to obtain the assets belonging to DS.

116. Warco, Landrin Insurance Corporation and Landis Insurance Corporation then issued separate Writs against DS in the Grand Court and on 19 July 2012 they obtained separate Default Judgments of US$886,881.20, US$48,000 and US$54,000.

117. From their investigation, the JOLs of Monkton established that at least US$657,000 of the US$875,000 received by Mr. Ritter had been misappropriated from other Monkton clients, or was otherwise a preferential payment. In light of this, on 9 August 2012 Monkton's Liquidators filed their Complaint against Mr. Ritter in the United States District Court, Western District of Texas ("the Texas proceedings") seeking to claw back the US$875,00 which Mr. Ritter had accepted from DS into his US account.

118. This is the stage at which Mr. Ritter changed his strategy concerning recovery of the sums improperly removed from the Geneva Account by DS. It became evident that the funds received under his "*Plan A*" might well have to be returned as the Monkton Liquidators were now seeking to recover from Mr. Ritter the stolen funds which had been wired into his personal account by DS. Mr. Ritter changed to his "*Plan B*", namely seeking recovery from the Bank. On 27 August 2012, Krys Global as Geneva's Joint Voluntary Liquidators wrote to the Bank to notify it of the fraud on the Geneva Account and that Mr. Ritter would now be challenging the debits for the payments made on DS's forgeries. Mr. Krys stated in evidence in chief that Krys Global did this after they had obtained legal advice, as they felt that there was a duty to put the Bank on notice and that he was not aware of Mr. Ritter ever informing the Bank of DS's confession to him that he had forged his name to misappropriate funds from the account. The letter did not say that Mr. Ritter had been aware of this since 1 September 2011, but gave the impression that it was something that he had only recently told Krys, as they said:

> "*he has now confirmed that the five payment instructions*"

had not been authorised by him. During cross-examination Mr. Krys stated that when they met, and when Krys Global was asked to carry out the forensic analysis, that Mr. Ritter did not accept that Mr. Ritter told Krys Global what he knew from what DS had told him, and that they:

> "*never talked about forgery*" but "*about there being a risk of fraud*" and "*concerns that his money may have been stolen.*"

When pressed about Mr. Ritter saying to him specifically that he had been told of a forgery he replied:

> "*I have no recollection of that and had we had that, I would have asked for evidence. And quite honestly, when we did our report, as you know, we say things like "Mr. Ritter has said that he didn't authorize a transaction" A much stronger statement would have been "Mr. Self has already confirmed or we have evidence that Mr. Self had actually forged his signature on this transaction."*"

Mr. William King, Relationship Manager at the Corporate Banking Division of the Bank, on 6 September 2012 in an internal email following receipt of the Krys letter indicated that DS had admitted to major fraud on other accounts he managed, but he made no mention of there being any admission from DS in relation to the Geneva Account. It appears from the evidence of Mr. Krys that this was the first time that the Bank was made aware that Mr. Ritter was saying that there had been unauthorised transactions on the Geneva Account and the Bank

rightly contend that this is the date they first knew about the fraud on the Geneva Account.

119. On 7 November 2012 CIMA revoked Monkton's Insurance Management Licence.

120. On or around 24 December 2012 DS was convicted of theft of monies from the Geneva Account and from other Monkton clients' accounts at the Bank.

121. On 9 April 2013 Mr. Ritter sought to join the Bank as a third party in the Texas proceedings. In cross-examination of Mr. Skinner about the Texas proceedings Mr. Ritter's counsel stated in a question to Mr. Skinner:

> *"...Mr. Ritter realizing he hasn't been made whole after all, reverts to his Plan B, which is to seek reimbursement against Butterfield for breach of mandate."*

Mr. Ritter accepted when being cross-examined that he sought to join the Bank in the Texas proceedings pursuant to his *"fallback option"* and that this was eighteen months after he had first found out about the forgery.

122. Mr. Ritter's third party complaint against the Bank was dismissed in the Texas proceedings on 5 September 2013. The Bank incurred US$183,000 Texas and Cayman legal fees in successfully defending its position that it ought not to be joined in the Texas proceedings.

123. Mr. Ritter defended the Texas proceedings incurring a consequential loss of legal fees totalling US$220,871.29. The Texas proceedings were settled by Mr. Ritter, on behalf of Geneva, paying US$500,000 to the Monkton liquidation estate. The Grand Court sanctioned this settlement on 12 March 2014. Geneva did not receive any dividend distribution from the US$500,000 settlement or at all from the liquidation. Geneva was permitted to retain US$375,000 of the original US$875,000 which Mr. Ritter had received from the evidently misappropriated funds in September 2011. US$330,000 was used to repay the Shoreline loan and interest and it is acknowledged that the balance of US$45,000 is a credit reducing the amount sought to be reimbursed from the Bank in these proceedings by US$45,000 and Mr. Ritter submits that, as a consequence, the Bank's position has in fact *"materially improved"* by it not taking action against DS in September 2011 which may have prevented the funds being transferred to Mr. Ritter on the 6 and 7 September 2011.

124. Mr. Ritter contends that due to the communications from the Controllers with the Bank, due to the arrest of DS on 17 February 2012[28], and the Bank being aware of the freezing of the bank accounts of all Monkton managed captive insurance clients due to fraudulent transactions on the same, the Bank must have been aware, or put on direct enquiry, about the fraud or likelihood of the fraud on the Geneva Account. Mr. Ritter indicates that the Bank failed in its *"duty"* to inform him in February 2012 that the Geneva account had been frozen and to explore with him the reasons why and as a consequence the Bank is estopped from

[28] DS was convicted in December 2012 after pleading guilty to related criminal offences.

denying the fraud and forgery from February 2012. This contention is made even though Mr. Ritter had failed to notify the Bank about the fraud/forgeries and that the communications and Court documents relating to the events in February 2012 made no mention that DS had forged transactions on the Geneva Account. Mr. Ritter highlights that this is consistent with the date for when the Bank should be taken to have been aware of the alleged fraud being February 2012, as had been pleaded in the Bank's original Defence dated 22 February 2016. By February 2012 there were no default judgments against DS, no creditor had taken action against him and the settlement between DS and the Controllers and the Liquidators to assign all his assets to them had not yet been reached. It is submitted that the amendment in the Amended Defence to August 2012 was a tactical one to enable the Bank to allege that the 3 July 2012 Judgments in default made in favour of the other Monkton creditors had materially prejudiced its position.

125. Mr. Skinner stated that, although the Bank was aware that Controllers had been appointed to Monkton and that DS was subject to a Freezing Order of his worldwide assets up to US$1.2 million, it was not until 27 August 2012, shortly before the proceedings had been commenced in Texas against Mr. Ritter, that the Bank was notified of Geneva's position and that the above-mentioned transfers had not been authorised by Mr. Ritter. This notification did not come from Mr. Ritter, but from the Voluntary Liquidators of Geneva and it did not disclose any detail about DS admitting the forgeries to Mr. Ritter. The Bank accept that from

the date of this letter it was aware of DS's fraud but it was not aware of DS forging Mr. Ritter's signature until the Texas proceedings were filed and served on the Bank in May 2013.

126. In light of the above, it is contended by the Bank that there was a deliberate decision not to inform the Bank with Mr. Ritter:

> "*taking matters into his own hands by making sure that (DS) repaid the missing funds to him personally, rather than Geneva*"

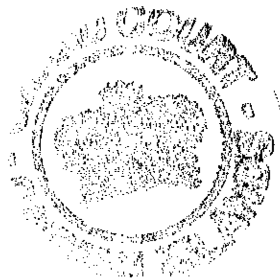
with Mr. Ritter accepting a payment of US$875,000 in suspicious circumstances. It is contended that Mr. Ritter was thereby looking after his own interests and failing in his duty as a Director of Geneva to promptly share his knowledge of the admitted forgery with the Bank.

The Law

127. The responsibility and liability of a bank towards its customer is governed by the applicable law and the relevant contract entered into between the two parties. The contract determines the manner in which the services will be provided and records the obligation of each party. In the event of an alleged breach by the Bank of an express or implied term of a contract, three elements need to be satisfied in order to establish liability: proof of breach by the bank against the customer, damages and causation between the breach and the damage suffered by the customer.

128. However, when I now move on to consider the Law in light of the above detailed factual matrix I remind myself that the parties agreed by Court Order to limit the issues to the two now before me, namely:

(i) Whether the Plaintiffs are estopped from advancing claims against the Bank in contract and negligence. When conducting this exercise, in circumstances where it is found that Mr. Ritter wrongly failed to notify the Bank of the forgeries until August 2012, I will also have to consider arguments about whether there is a requirement for the Bank to show that it has been materially prejudiced by the delay, and if it is has there been any such detriment; and then,



(ii) Whether the Bank dishonestly assisted in a fraud involving forgeries of Mr. Ritter's signature by DS.

129. The general rule is that the Bank is ordinarily not entitled to debit the customer's account if it has honoured a wire transfer/a wire transfer instruction bearing a forged signature. However a defence available to a paying bank may arise if the customer has breached his duty to the Bank in failing to inform the Bank of any forgery on the account as soon as the customer became aware of it. The Bank seeks in this matter to prevent the Plaintiffs from advancing their claim in contract and negligence against it, arguing that they are estopped from doing so due to a failure to inform.

The Law – General Principles Regarding the Elements of Estoppel

130. To establish the defence of estoppel the Bank will have to prove that Mr. Ritter failed to promptly report what he knew about the forgeries to the Bank and that he took that course intentionally. The Bank must also prove that his not informing the Bank of the forgery amounted to a representation that the transfer requests were in order. If able to prove the above, the Bank must then prove that by its acts or omissions it relied upon the representations made, the Bank contending that it did so by not bringing recovery proceedings against DS at a time when he still had financial resources/was not subject to default judgments or by allowing later fraudulent transactions to be made from bank accounts held at the Bank. If able to prove the same, the Bank would then have to prove that the acts and omissions caused it detriment, the Bank contending that it did, as it lost an opportunity to recover from DS and it made substantial payments out of other bank accounts and had incurred litigation costs as a consequence. The Plaintiffs contend that the Bank, to prove detriment, must show that the lost opportunity offered a real prospect of benefit. The Plaintiffs contend that the Bank has failed to prove the required elements of estoppel.

131. What has commonly been termed the "Greenwood duty" arose in the House of Lords case of ***Greenwood v Martins Bank*** [1933] A.C 51. In ***Greenwood*** a wife forged her husband's signature on 44 cheques. She then cashed the cheques and used the proceeds for her own use, primarily to support her sister in supposed legal proceedings. Upon discovering the forgeries, under pressure from the wife,

the husband failed to at once inform the bank. It was only later that he decided to tell the bank and, after he had informed his wife of his intention, she committed suicide. The failure to inform the bank in a timely manner resulted in the bank losing its right/opportunity to claim against the wife and the husband for the wife's tort and the Court found that this amounted to the bank having suffered loss or detriment. The husband sought a declaration that he was entitled to be credited with the sums debited from his account by the wife using the forged cheques. The Court held that where a customer's signature to a cheque is forged, it is the duty of the customer, on discovering the forgery, to bring that fact to the attention of the bank and if he deliberately abstains from doing so, with the result that the bank loses its remedy against the forger, the customer is estopped from relying on the forgery. Accordingly, the House of Lords found that all the essential elements to estoppel were made out and the husband was unable to recover the debited sums.

132. Lord Tomlin stated what the elements of estoppel are at pages 57-58 and 59:

> *"The essential factors giving rise to an estoppel are I think:-*
>
> *(1.) a representation or conduct amounting to a representation intended to induce a course of conduct on the part of the person to whom the representation is made.*
>
> *(2.) An act or omission resulted from the representation, whether actual or by conduct, by the person to whom the representation is made.*
>
> *(3.) Detriment to such person as a consequence of the act or omission.*
>
> *Mere silence cannot amount to a representation, but when there is a duty to disclose deliberate silence may become significant and amount to a representation....*

> *The deliberate abstention from speaking in those circumstances seems to me to amount to a representation to the respondents that the forged cheques were in fact in order, and assuming that detriment to the respondents followed there were, it seems to me, present all the elements essential to estoppel."*

133. Lord Tomlin went on to say that it is immaterial that the bank was guilty of negligence in not detecting the forgery in such circumstances. He rejected the submission that the respondent's initial negligence made a difference stating at pages 58-59:

> *"Further, I do not think that it is any answer to say that if the respondents had not been negligent initially detriment would not have occurred. The course of conduct relied upon as founding the estoppel was adopted in order to leave the respondents in the condition of ignorance in which the appellant knew they were. It was the duty of the appellant to remove the condition however caused. It is the existence of this duty, coupled with the appellant's deliberate intention to maintain the respondents in their condition of ignorance, that gives its significance to the appellant's silence. What difference can it make that the condition of ignorance was primarily induced by the respondent's own negligence? In my judgment it can make none. For the purposes of estoppel, which is a procedural matter, the cause of the ignorance is an irrelevant consideration."*

134. ***Greenwood*** does not support the view that an estoppel should arise where the customer has the means, by the exercise of reasonable care, to acquire knowledge of

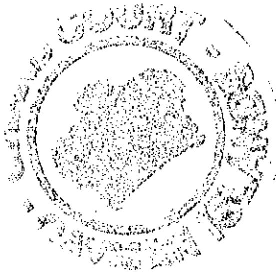
the forgery but fails to do so. On the other hand, I also note that the Court of Appeal and the House of Lords rejected the contention that a bank cannot rely on estoppel:

> *"when the loss is attributable, even in part, to his own negligence; as where he has failed to detect an obvious forgery or alteration."*

135. It is evident from Lord Tomlin's judgment that he was aware of the earlier decision of the House of Lords in ***M'Kenzie v British Linen Company*** (1881) 6 App. Cas 82 (HL) and that the Court of Appeal, whose decision was upheld, had applied the same authority. In that case it was held that a person (even if he was not in a contractual relationship with the bank) who knew that a bank was relying upon a forged signature to a bill of exchange could not lie by and not divulge the fact until he saw that the position of the bank was altered for the worse; but there was no principle on which his mere silence for a fortnight, from the time when he first knew of the forgery during which time the position of the bank was in no way altered or prejudiced, could be held to be an admission or adoption of liability, or an estoppel. Therefore it was held that he was not estopped because his silence had not prejudiced the bank.

136. In ***M'Kenzie*** Parke B.'s views concerning estoppel expressed by him in ***Freeman*** were approved, and Lord Watson speaking to the basis of the duty to speak in such circumstances in terms which assumed knowledge of the forgery stated at p. 109:

> *"The only reasonable rule which I can conceive to be applicable in such circumstances is that which is expressed in carefully chosen language by Lord Wensleydale in the case of Freeman v. Cooke. It would be a most unreasonable thing to permit a man who knew the*



> *bank were relying upon his forged signature to a bill, to lie by and not to divulge the fact until he saw that the position of the bank was altered for the worse. But it appears to me that it would be equally contrary to justice to hold him responsible for the bill because he did not tell the bank of the forgery at once, if he did actually give the information, and if when he did so, the bank was in no worse position than it was at the time when it was first within his power to give the information."*

137. At page 268 in the House of Lords decision of ***Ogilvie v West Australian Mortgage and Agency Corpn Ltd*** [1896] AC 257 Lord Watson said in regard to ***M'Kenzie*** and "*similar cases*" that:

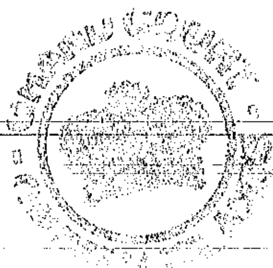
> *"The ground upon which the plea of estoppel rested in these cases was the fact that the customer, being in the exclusive knowledge of the forgery, withheld that knowledge from the bank until its chance of recovering from the forger had been materially prejudiced."*

138. The Court of Appeal in ***Greenwood*** relied also on the "*well established*" rule in ***Pickard v Sears*** (1837) 6 A & E 469. Scrutton L.J., relevant to the issue of intention/representation, at page 379 referred to the "*classic exposition*" of the principle of estoppel given by Parke B. in ***Freeman*** when he cited the rule in ***Pickard*** as:

> *"That, where one, by his words or conduct, wilfully causes another to believe in the existence of a certain state of things, and induces him to act on that belief, or to alter his own previous position, the former is concluded from averring against the latter a different state of things as existing at the same time."*

Scrutton L.J. then added at page 380 that:

> *"by the term wilfully ... (in the Pickard rule), we must understand, if not that the party represents that to be true which he knows to be untrue, at least, that he means his representation to be acted upon, and that it is acted upon accordingly; and if, whatever a man's real intention may be, he so conducts himself that a reasonable man would take the representation to be true, and believe that it was meant that he should act upon it, and did act upon it as true, the parties making the representation would be equally precluded from contesting its truth."*



139. The Privy Council decision in ***Tai Hing Cotton Mill Ltd v Liu Chong Himg Bank Ltd*** [1986] AC80 (PC) considered the scope and extent of the Greenwood duty of the customer to inform the bank of a known forgery. In ***Tai Hing Cotton Mill Ltd***, a fraudulent accounts clerk employed by the company forged the signature of the company's managing director on 300 cheques to the value of HK$5.5M, drawn on the company's accounts at three banks, over a period of five years. The company did not learn about the frauds until a newly appointed accountant embarked on a course, one not previously taken, of reconciling the bank statements with the company's account books. When the frauds were uncovered, the company requested each bank to credit its accounts with the amounts of the forged cheques, which the banks had already debited. The banks declined this request and argued that a customer owes a duty of care to his bank to take such precautions as a reasonable customer would take to prevent forged cheques being presented to the bank for payment, and to check his bank statements for unauthorised debit terms. The Judicial Committee of the Privy

Council rejected these arguments of the banks and held that banks which had paid out on forged cheques were not entitled to debit their customers' accounts with these amounts since, unless it was otherwise agreed, the duty of care owed by a customer to his bank in the operation of his current account was limited to a duty to refrain from drawing a cheque in such manner as to facilitate fraud or forgery and the Greenwood duty to inform the bank of any forgery of a cheque purportedly drawn on the account as soon as he became aware of it. Lord Scarman referring to the Greenwood duty stated at page 101C-G that:

> *"If put in terms of principle, the question is whether English law recognises today any duty of care owed by the customer to his bank in the operation of a current account beyond, first, a duty to refrain from drawing a cheque in such a manner as may facilitate fraud or forgery and, second, a duty to inform the bank of any forgery of a cheque purportedly drawn on the account as soon as he, the customer, becomes aware of it. The first duty was clearly enunciated by the House of Lords in London Joint Stock Bank Ltd v Macmillan [1918] AC 777, [1918-19] All ER Rep 30 and the second was laid down, also by the House of Lords, in Greenwood v Martins Bank Ltd [1933] AC 51, [1932] All ER Rep 318."*

It is clear from ***Tai Hing Cotton Mill Ltd*** that Mr. Ritter had a responsibility to inform the Bank of DS's forgery when he first became aware of it on 1 September 2011. In the matter before me, it is not one in which the Court must consider constructive notice of the forgeries as it is beyond all doubt that he had actual knowledge of them due to the content of his conversation with DS on 1 September 2011.

140. As highlighted in the Encyclopaedia of Banking Law LexisNexis Issue 148 at C405, with reference by the authors to the decision in ***Ogilvie*** and the decision in ***Fung Kai Sun v Chan Fui Hing*** [1951] AC 489, PC, a customer must also immediately notify the bank of the forgery:

> *"even though repetition of the forgery (with consequent further loss) is unlikely or impossible as failure to do so"*

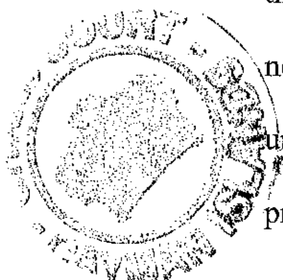
may enable the forger to dissipate sums and remove all his assets, thereby depriving the bank of the effective remedy.

141. It appears that the parties agree the above uncontentious and now established principles concerning the elements of estoppel extracted from the aforementioned cases. However, they disagree about how the law applies to the facts in this matter.

142. In addition, it appears to be wrongly argued by the Plaintiffs that the Bank also needs to prove that it was otherwise unconscionable for the Plaintiffs to be reimbursed. The Plaintiffs may also be arguing that Bank also needs to prove that it was otherwise unconscionable for the Plaintiffs to deny their representation that forged transfers were in order. For some types of estoppel (for example promissory estoppel and estoppel by convention), inequitable or unconscionable conduct is a substantive element of the estoppel, whereas in others on a proper analysis it is not. In the above types of estoppel there is no required element that the promisee was induced by the promise or convention to act to his detriment.

Equity has also come into play where there are specific other defences, for example defence of change of position.[29]

143. In the cases of estoppel by representation, on the other hand, there is a required element that has to be proved that the representee was induced to act to his detriment by the representation of the representor and to his knowledge. If all of the elements of the estoppel are present then there will be an estoppel. There is no need for any separate assessment of whether or not the conduct of Mr. Ritter was unconscionable as that question has already been answered if the elements are proved.



144. I will now move on to deal with each element of estoppel and the wider and more contentious case law produced by the parties.

The Law - Representation

145. I have found that Mr. Ritter first became aware of the forgery on 1 September 2011. I have found that it was not until receipt of the letter from Krys Global on 27 August 2012 that the Bank first received notice of the forgery. I have found that Mr. Ritter failed in his duty (*"the Greenwood duty"*) to notify the Bank of the forgery, which he should have done so on 1 September 2011 as soon as it came to his notice following DS's confession to him. Mr. Ritter, once he had knowledge of the forgeries, remained silent and did not otherwise act to enable the Bank to recover from DS the money already paid out. Despite these findings the Bank

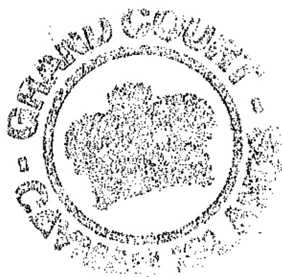
[29] See from paragraph 163 herein.

must still go on to prove that Mr. Ritter's conduct, by remaining silent between 1 September 2011 and 27 August 2012, amounted to a representation.

146. Mr. Ritter rightly points out that ***Greenwood*** establishes that mere silence cannot amount to representation, but where the duty to disclose exists, as it does in this case:

> *"deliberate silence may become significant and amount to a representation*[30]*."*

In ***Greenwood*** the House of Lords found that Mr. Greenwood's silence:



> *"was deliberate and intended to produce the effect which it in fact produced – namely the leaving of the respondents in ignorance of the true facts so that no action might be taken by them against the appellant's wife. The deliberate abstention from speaking in those circumstances seems to me to amount to a representation to the respondent that the forged cheques were in fact in order, and assuming that detriment to the respondents followed there were, it seems to me, present all the elements essential to estoppel."*

147. In light of my findings and the nature of the clear facts in this case, I need not carry out a wider review of the law on the element of representation. I have found for the reasons already stated herein that Mr. Ritter's silence was deliberate and intended to ensure receipt of and the securing of the funds transferred by DS into his personal account in the USA. The belatedly raised arguments raised in attorney to attorney correspondence and at trial concerning the tipping off offence

[30] Lord Tomlin at Page 57.

provisions in the Proceeds of Crime Law, which Mr. Ritter was evidently unaware of at the relevant time, are without merit. His excuse for not telling the Bank of the forgery because he was concerned that to do so would tip off any bank employee who might be an accomplice of DC was motivated, not by the provisions in the Proceeds of Crime Law, but by his wish to preserve his financial position.

Detriment

148. For the defence of estoppel to be established, the Bank must also go on to prove material detriment as a consequence of Mr. Ritter's representation. It is clear from Lord Watson's analysis on pages 111-112 in ***M'Kenzie*** that mere silence without resulting injury or prejudice to the Bank, would not raise an estoppel.

149. The Privy Council decision in ***Fung Kai Sun*** which was considered in ***Greenwood***, addressed what may amount to detriment. The case involved forged mortgages and it was held following the authorities of ***M'Kenzie*** and ***Ewing***, that the principle of estoppel by silence, where there is a duty to inform, applied to a case in which there was no contractual relationship between the parties, but in the particular circumstances the respondents were not estopped because the appellant had not established detriment. Lord Reid determined that detriment would arise if the bank's chance of recovering from the forger has been "*materially prejudiced*". He stated at page 503:

> *"In their Lordships' judgment it must be held that the respondents were not entitled to withhold from the appellant information that the appellant's mortgages were forgeries, and that when they*

chose to do so they took the risk that they would later be estopped from asserting that these deeds were forged if by reason of their keeping silent the appellant suffered detriment. Accordingly, the next question for consideration is whether the respondents, having delayed from June 1 to June 23 to inform the appellant that his mortgages were forgeries, cause any such detriment to the appellant as will now give rise to estoppel. The only detriment suggested is that if the appellant had been formed on or about June 1 he might have been able to take some more effective action to minimise his loss than it was possible for him to take after June 23, and the only action which he could have taken would have been action against the forger or his property. The forger,..., had real property in Hong Kong of substantial value, but there is no evidence that this was less available to the appellant after June 23 than it had been before.

Lord Reid on page 506:

"In their Lordships' judgment, this is the true test: the chance of recovering must have been materially prejudiced by the delay."

150. In the Privy Council decision given in ***Kelly and others v Fraser*** [2012] UKPC 25 further consideration was given to the test for detriment. At paragraph 17 Lord Sumption stated:

"The relevance of detrimental reliance in the law of estoppel by representation is that it is generally what makes it unjust for the representor to resile from his previously stated position. However, for this purpose, the ordinary rule is that the detriment is not the measure of the representee's relief, and need not be commensurate with the loss that he would suffer if the representor did resile: see

> *Avon County Council v Howlett [1983] 1 WLR 605, where the authorities are reviewed by Slade LJ at pp 620-625. Indeed, the detriment need not be financially quantifiable, let alone quantified, provided that it is substantial and such as to make it unjust for the representor to resile. A common form of detriment, possibly the commonest of all, is that as a result of his reliance on the representation, the representee has lost an opportunity to protect his interests by taking some alternative course of action. It is well established that the loss of such an opportunity may be a sufficient detriment if there were alternative courses available which offered a real prospect of benefit, notwithstanding that the prospect was contingent and uncertain: Greenwood v Martins Bank Ltd [1933] AC 51 and Ogilvie v West Australian Mortgage and Agency Corporation Ltd [1896] AC 257, 268, as explained in Fung Kai Sun v Chan Fui Hing [1951] AC 489, 505-6."*

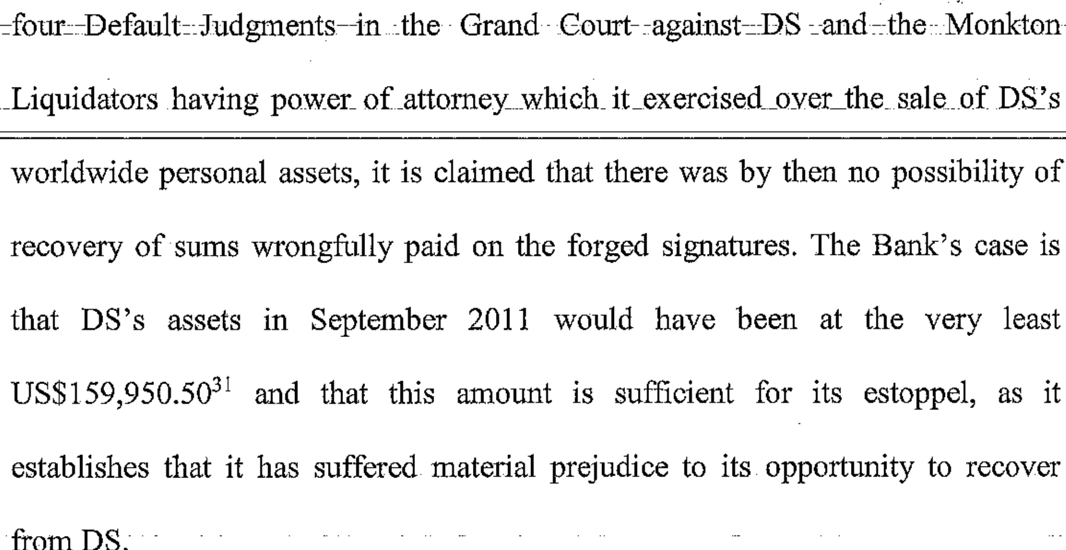
151. The Bank contends that it has suffered material prejudice, especially as DS's assets were no longer available for recovery by them by the time that they were notified of the fraud. The Bank contends that it had:

> *"a real prospect of benefit, notwithstanding that the prospect was contingent and uncertain".*

It is argued that any uncertainty in respect of the likely recovery should be decided in favour of the Bank and that the inability to quantify the detriment does not mean that the prejudice cannot be established.

152. It is argued that detriment arises as the loss that the Bank has suffered is the lost opportunity to recover from DS the funds that it paid out, in a claim under the tort

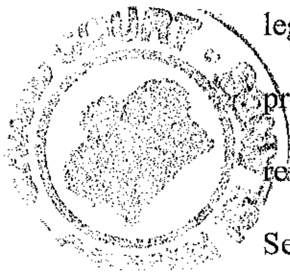
of deceit for DS's fraudulent misrepresentation which would have been brought. DS had assets on 1 September 2011 when Mr. Ritter first became aware of the forgery, which no longer existed by 27 August 2012 when the Bank first became aware of the forgery. By the time the Bank had been made aware of the fraudulent transfers from the Geneva Account by Krys Global on 27 August 2012, due to the four Default Judgments in the Grand Court against DS and the Monkton Liquidators having power of attorney which it exercised over the sale of DS's worldwide personal assets, it is claimed that there was by then no possibility of recovery of sums wrongfully paid on the forged signatures. The Bank's case is that DS's assets in September 2011 would have been at the very least US$159,950.50[31] and that this amount is sufficient for its estoppel, as it establishes that it has suffered material prejudice to its opportunity to recover from DS.



153. The Plaintiffs accept that the Bank could have brought proceedings against DS for the tort of deceit and against Monkton if it had suffered loss and was able to claim damages. It is submitted that for them to be able to do this they would have had to have reimbursed the Plaintiffs for the losses arising out of the forgeries in the sum of $529,191. It is suggested, based on the Bank's pleaded Defence to the Plaintiffs' claims relying upon the standard terms and conditions which it is argued excluded liability for forgery and the line of cross-examination of Mr. Ritter set out at paragraph 28 of the Plaintiffs' Closing Written Submissions as well as Mr. Skinner's evidence in chief about taking legal advice and considering

[31] US$159,950.05 being the value that DS's assets sold by Monkton' JOLs in 2012.

its position before commencing proceedings against DS, that even if the Bank was aware of the forgery on 1 September 2011, it would not have promptly reimbursed Geneva and would have not done so without a careful analysis of its legal position. It is also contended that the Bank's position in resisting the Texas proceedings is an indication that the Bank would not have suffered loss by reimbursing the Plaintiffs if they had received knowledge of the forgery in September 2011.



154. It is suggested that in light of the fact that the defrauded captive insurance companies[32] only obtained Default Judgments in relation to other defrauded captive insurance clients in July 2012 after gaining knowledge of those specific frauds in February 2012, it would have taken the Bank at least five months to obtain default judgment in relation to the Geneva Account fraud. However, I note that the Monkton JOLs obtained their Default Judgment with damages to be assessed on 8 March 2012. It is further contended that, if the Bank had brought proceedings in September 2011, the other defrauded creditors would become aware of that and they would have issued proceedings and that the Authorities including CIMA and the police would also have acted resulting in controllers liquidators being appointed. It is suggested in such a scenario that all the creditors, even with Default Judgments, would be confined to recovery in the Monkton liquidation. Accordingly, even in light of Mr. Skinner's indication in evidence that he believed that the Bank would have been in the same position as the Monkton Controllers in relation to assignment of DS's assets within one to

[32] Represented by Campbells Attorneys-at-Law.

two months from first acquiring knowledge of the forgery, it is contended that any advantage from early notification of the forgery would have been lost and there was therefore no real prospect of benefit. However, it is clear that the claim by the Bank would be one brought against DS and would therefore not fall within the Monkton liquidation.

155. The Plaintiffs contend that, in any event, assets for potential recovery in September 2011 or February 2012 would not have been significant and that, at most, their value would be around US$160,000 which would have to be used to meet the Controllers and JOLs' fees and then all creditors' claims. However, the claim if promptly made by the Bank would have been made against DS and would not have resulted in them being a creditor of Monkton's. Reliance is placed upon the JOLs report dated 30 April 2012 in which there is (i) a finding that DS used his ill-gotten gains from Geneva to pay for intangible items and (ii) a conclusion that:

> *"The liquidators do not believe there are any major assets, whether belonging to the Company or (DS), which would likely to result in a substantial recovery for the company were they immediately pursued."*

The Plaintiffs also point out that the funds to repay Mr. Ritter came from Canadian Livestock and Warco Corporation on 2 September 2011 and that DS was attempting to re-mortgage his Seven Mile Beach Condominium in January/February 2012 and contend that this is an indication that he did not have other assets to draw on despite the threats of Mr. Ritter to report him to the

criminal authorities if there was no repayment. The Bank, on the other hand, contend that DS is a fraudster and that using these funds, rather than his own assets is to be expected and does not support a contention that he did not have other assets.

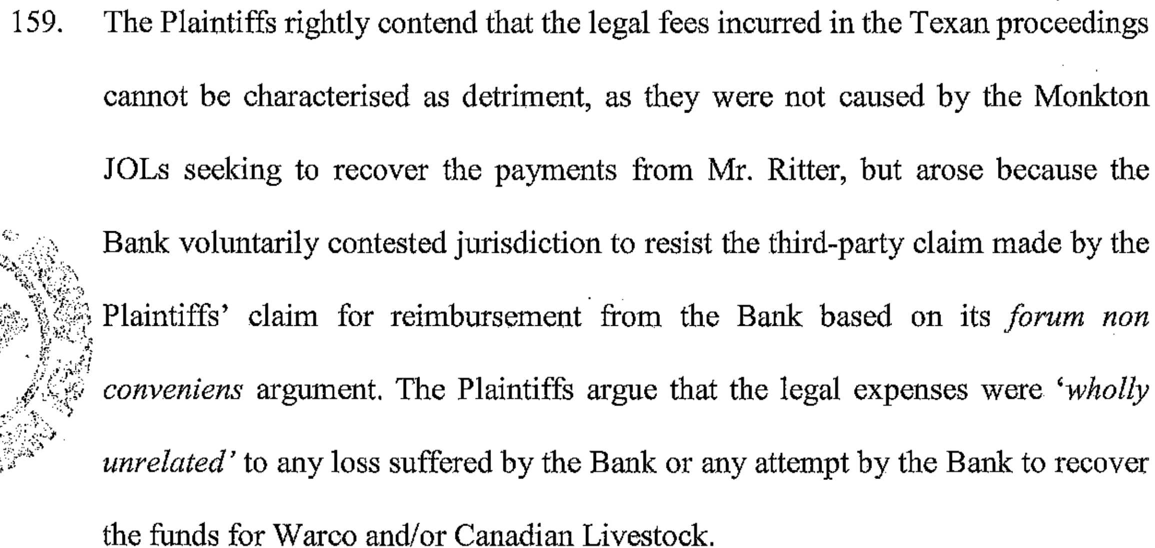
156. The Plaintiffs highlight that, by 7 September 2011, it appeared that they had received all the sums due from DS and therefore, at that time, no relief would have been sought from the Bank and it is submitted that as a consequence the Bank could not have claimed any loss which they would be required to do in the available claim in tort. It is further contended that if the Bank had been notified of the forgery after 7 September 2011 before August 2012, a time period when the Plaintiffs believed they had been repaid in full, there would have been no cause of action for that only arose again in August when Mr. Ritter sought to recover against the Bank.

157. The Plaintiffs, unlike the Bank, contend that the Bank may have also brought a subrogated claim against Monkton. It is argued that under such a claim there would have been no assets available for distribution to the Bank or to any of the other creditors. The Plaintiffs suggest that if a successful claim had been made against Monkton in a two year period ending in April 2012, the date when the liquidation commenced, that any payment may have been set aside as a voidable preference. The Bank rightly contends that this matter does not raise a subrogated claim against Monkton as there is no dispute, having regard to the authority of

Foley v Hill [1848] II H.L.C, that the funds paid out were the Bank's and not the customers' funds and therefore it had its own claim for loss and did not need to be subrogated to Geneva's claim. The immediate and straight forward claim the Bank had and makes in tort is against DS as an individual and therefore would not involve a s.145 Companies Law claw back of preferential payment made by a company in liquidation made to creditors.

158. It is further contended by the Bank that there is detriment as the Bank incurred US$183,000 in legal fees defending the third party complaint issued by Mr. Ritter in the Texas proceedings, which the Bank states would not have been commenced if the Bank had been informed by Mr. Ritter about the forgery on 1 September. The Bank argues that the failure to make the report hindered the ability to prevent further frauds, in particular in relation to the transfers to Warco and Canadian Livestock amounting to US$825,000. DS would have been prevented from transferring the money to Mr. Ritter personally as the Bank would have placed a block on and not have then allowed the US$550,000 and US$276,000 payments to be processed in 2 September 2011.[33] If these transfers had not occurred then, it is submitted, legal costs would not need to have been spent on the proceedings in Texas by the Bank as well as by the Liquidators who used up the proceeds that could have gone to creditors including Geneva to meet their costs which had escalated due to the manner of Mr. Ritter's defence to those proceedings.

[33] See paragraph 47 - The Monkton JOLs sought to claw-back these payments in the Texas proceedings.



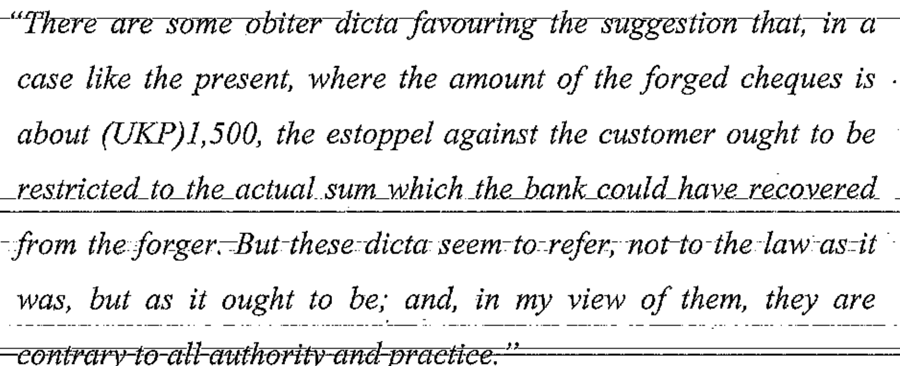
159. The Plaintiffs rightly contend that the legal fees incurred in the Texan proceedings cannot be characterised as detriment, as they were not caused by the Monkton JOLs seeking to recover the payments from Mr. Ritter, but arose because the Bank voluntarily contested jurisdiction to resist the third-party claim made by the Plaintiffs' claim for reimbursement from the Bank based on its *forum non conveniens* argument. The Plaintiffs argue that the legal expenses were '*wholly unrelated'* to any loss suffered by the Bank or any attempt by the Bank to recover the funds for Warco and/or Canadian Livestock.

160. The Plaintiffs correctly highlight that these two transactions, which the Bank claims that they may have been able to prevent if the fraud had been reported to them, did not result in any direct loss to the Bank as they were not liable to reimburse and as a consequence any claim for estoppel cannot be based upon them.

Can the Estoppel Operate Pro Tanto?

161. The Plaintiffs submit that if the Court were to find that the Bank has been materially prejudiced by a loss of opportunity to sue DS, that it should find that estoppel by representation operates pro tanto. In other words the Plaintiffs should not be estopped to the full extent of their claims, but only to the extent of actual potential detriment found to have been suffered by the Bank.

162. This is not in line with the view expressed by Lord Watson in ***Ogilvie*** who stated at page 270 that:



> *"There are some obiter dicta favouring the suggestion that, in a case like the present, where the amount of the forged cheques is about (UKP)1,500, the estoppel against the customer ought to be restricted to the actual sum which the bank could have recovered from the forger. But these dicta seem to refer, not to the law as it was, but as it ought to be; and, in my view of them, they are contrary to all authority and practice."*

163. The Plaintiffs place reliance upon the developing law in mistaken payment cases which involve both estoppel by representation and the defence of change of position. The use of estoppel in mistaken payment cases was regarded as being unsatisfactory because estoppel by representation was generally viewed as an all or nothing defence. This led to Lord Goff stating in ***Lipkin Gorman v Karpnale Ltd*** [1991] 2 AC [548] at 579E, the case in which the House of Lords recognised the defence of change of position, that:

> *"in many cases, estoppel is not an appropriate concept to deal with the problem."*

This view was held because: (i) although in certain factual circumstances where there is no proof of detrimental reliance it will be unlikely, or perhaps even impossible, for the defence to be made out, the position is that, as a matter of law, the defence of change of position is not dependent upon proof of some representation by the payer, nor is it dependent upon proof of any detrimental

reliance on the part of the payee, and (ii) estoppel was an inflexible all-or-nothing defence.

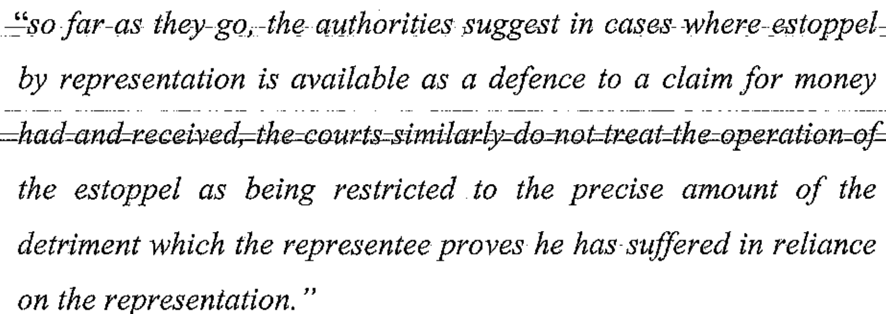
164. In ***Avon County Council v Howlett*** [1983] 1 WLR 605 the Court of Appeal held that if a defendant can establish an estoppel, this generally operates as a complete defence and not pro-tanto. Slade L.J. emphasised that estoppel by representation is in origin a rule of evidence, and that that is what confers its 'all or nothing' character. In ***Avon*** the plaintiff made an UKP1,007 overpayment of sick pay wages to the defendant, a teacher employee. The teacher queried the overpayments but was told they were correct. By the time the Council had realised their mistake, the teacher had spent most of it. The plaintiff sought to recover the overpayment on the grounds that it had been paid by mistake. The Court of Appeal held that the defence of estoppel prevented the Council from recovering the whole sum of the overpayment. It was held that as the plaintiff had discharged the onus of proving that the overpayment had occurred due to a mistake of fact, it was prima facie entitled to recover the full amount of the overpayment but because the plaintiff had represented to the defendant that he was entitled to the sum of money paid, the plaintiff was estopped from seeking recovery of the overpayment. The estoppel gave a total defence to the claim although the detriment suffered was only in the region of UKP550.

165. Slade L.J. stated at page 622D that:

> "*.. if a bank's customer is estopped from asserting that the cheque with which he has been debited is a forgery, because of his failure*

to inform the bank in due time, so that it could have had recourse to the forger, the debit will stand for the whole amount and not merely that which could have been recovered from the forger."

Slade L.J. then went on to comment upon the cases of ***Ogilvie*** and ***Greenwood*** adding at page 622G that:



"*so far as they go, the authorities suggest in cases where estoppel by representation is available as a defence to a claim for money had and received, the courts similarly do not treat the operation of the estoppel as being restricted to the precise amount of the detriment which the representee proves he has suffered in reliance on the representation.*"

166. Slade L.J. also referred to the cases of ***Skyring v Greenwood*** (1825) 4 B&C 281 and ***Holt v Markham*** [1923] 1 KB 504, commenting at page 624 that if estoppel by representation could operate in a limited and proportionate way the courts which decided those cases:

> "*would have been bound to conduct a much more exact process of quantification of the alteration of the financial positions of the recipients, which had occurred by reason of the representations.*"

167. The members of the Court of Appeal in ***Avon*** recognised that there may be cases where it was inequitable or unconscionable for the recipient to rely on the fact that he had spent part of the mistaken overpayment to resist a claim for the balance. Slade LJ said at page 624H- 625A that an exception might arise to this general rule:

"*where the sums sought to be recovered were so large as to bear no relation to any detriment which the recipient could possibly have suffered.*"

Apart from that comment the Court of Appeal did not elaborate on what circumstances there might be to make a pro tanto approach appropriate and they did not reconcile their comments with their view that, if a defendant can establish an estoppel, this would generally operate as a complete defence and not pro-tanto.

168. In ***Scottish Equitable plc v Gordon Derby*** (2001) 3 All ER 1073 the holder of a pension policy was ordered to pay back the full amount of UKP172,000 after he had been wrongly advised about the total value of his rights under the policy. It is evident that the Court of Appeal felt that the case fell within the exception highlighted by Slade L.J. in ***Avon*** when it adopted a pro tanto approach. Unlike in the matter before me, the Court of Appeal had to review the law of restitution and the change of position defence, with the Court of Appeal recognising the link between that and estoppel by representation. When considering the role of the estoppel by representation where the change of position defence also existed, the Court of Appeal highlighted that two conflicting remedial outcomes existed, one in restitution where there was a pro tanto change of position defence and in estoppel where there was a complete estoppel by representation defence.

169. Walker L.J. considered two approaches to the conflict. One avenue being the 'minimum equity' concept, which Walker L.J. called a:

> "*more unified doctrine of estoppel*" and "*a move away from the evidential origin of estoppel by representation*",

where the estoppel would provide the minimum remedy to reverse the detriment. The second avenue, a novel one suggested by counsel, being that since ***Lipkin Gorman***, there is no role for estoppel as the defence of change of position pre-empts and disables the defence of estoppel by negativing detriment. Although he did not base his conclusion on the submission, Walker L.J. stated that he found the argument "*ingenious*" and "*convincing*" and he went on, at the penultimate paragraph of his decision, to make the following observation:

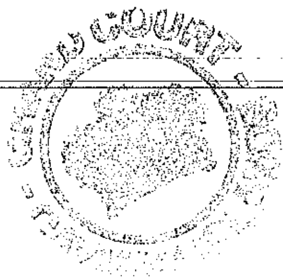
> "*Will estoppel by representation wither away as a defence to a claim for restitution of money paid under a mistake of fact? It can be predicted with some confidence that with the emergence of the defence of change of position, the court will no longer feel constrained to find that a representation has been made, in a borderline case, in order to avoid an unjust result. It can also be predicted, rather less confidently, that development of the law on a case by case basis will have the effect of enlarging rather than narrowing the exception recognised by this court in Avon County Council v Howlett. That process might be hastened (or simply overtaken) if the House of Lords were to move away from the evidential origin of estoppel by representation towards a more unified doctrine of estoppel, since proprietary estoppel is a highly flexible doctrine which, so far from operating as 'all or nothing', aims at "the minimum equity to do justice" (Crabb v Avon District Council [1976] Ch 179, 198). Paul Key has drawn attention (Excising Estoppel by Representation as a Defence to Restitution [1995] CLJ 525, 533) to two decisions of the High Court of Australia (Waltons Stores (Interstate) v Maher (1988) 164 CLR*

387 and Commonwealth of Australia v Verwayen (1990) 170 CLR 394) which he describes as a fundamental attack on the traditional perception of estoppel as a complete defence."

170. In a more recent decision, made also in the context of restitution for a mistaken payment, ***National Westminster Bank Plc v Somer International (UK) Ltd*** [2001] EWCA Civ 970 the bank had, by mistake credited the defendant company's account with US$76,706 which had been intended for a another customer's account. Upon being notified by the bank that a dollar payment had been received, the company believed it was the payment of between US$72,000 to $78,000 it was expecting from an overseas client, the company released further goods to that client to the value of £13,180.57 (or $21,616.14). When the bank discovered the mistake it sought to recover the sum of $76,708.57 wrongly credited to the company. In the interim, the company's client had ceased to trade, having failed to pay for the further goods delivered to it after April 1997. The company raised a plea of estoppel by representation against the bank as to the entirety of the sum mistakenly transferred, claiming that it had replied to his detriment by despatching the goods. The judge and the court below had allowed the plea only to the extent of the $21,616.14 and ordered company to repay the balance.

171. The issue for the Court of Appeal was whether the judge was wrong in following the decision in ***Scottish Equitable plc*** rather than the decision in ***Avon.*** The Court of Appeal held that:

> *"(i) it was unattractive that, in a case of money paid under a mistake of fact, the extent of the recovery should depend on whether or not the payment had been accompanied by a representation that the transferee was entitled to the payment;*
>
> *(ii) it was also clear that, where there had been such a representation, the doctrine of estoppel by representation appeared, subject to any equitable adjustment to reflect the actual detriment suffered, to dictate an "all or nothing" approach to the amount that could be recovered;*
>
> *(iii) Scottish Equitable recognised that there remained scope for the operation of equity to alleviate the position on grounds of unfairness or unconscionability; and*
>
> *(iv) in this case, the judge had been entitled to find that the actual detriment suffered by the company went to only part of the sum transferred mistakenly transferred to it, and that it would be unconscionable for it to retain the balance."*



172. Potter L.J. at paragraphs 44-45 observed in relation to the cases ***Olgivie*** and ***Greenwood*** that:

> *"44. In Howlett the court cited three cases which suggested that, where estoppel by representation is raised as a defence to a claim for money had and received, the courts do not treat the operation of estoppel as being restricted to the precise amount of the detriment which the representee proves he has suffered in reliance on the representation: Skyring -v Greenwood 4B.&C. 281, citing a passage from the judgment of Abbott CJ at 289; Holt -v-Markham [1923] 1 KB 504; and Lloyds Bank Limited -v- Brooks, 6 Legal Decisions Affecting Bankers for the Arbitrators Award of 14 September 2000. The court also cited Ogilvie -v- West Australian Mortgage and Agency Corporation Limited [1896] AC 257 and*

Greenwood -v- Martins Bank Limited [1932] 1 KB 371 (affirmed in the House of Lords [1933] A.C. 51) as demonstrating that a claimant who, as a result of being able to rely on estoppel, succeeds on a cause of action on which, without being able to rely on it, he would necessarily have failed, may be able to recover more than the actual damage suffered by him as a result of the representation which gave rise to it.

45. It is difficult to see how the last two cases support the principle for which they were cited. In each case a bank customer discovered that cheques drawn on his account had been forged, but failed to inform the bank until a substantial period had elapsed. <u>In each case it was held that there was no need to investigate whether the bank could in fact have recovered money from the forger had it acted immediately. The banks had not received benefit, but had suffered loss of any opportunity for recovery elsewhere, as to which the uncertainty of such recovery was resolved in favour of the representee[34].</u> That point is made in Goff & Jones: the Law of Restitution (5th ed) at 832."

This view addresses the unfairness that would result for a bank if it was required to prove precisely what it would have recovered if it had not lost the opportunity for recovery due to the failure of the customer failing to report his knowledge of the forgery for an extended period of time.

173. These modern decisions arose where the courts were dealing with the issue of the relationship between the defence of change of position and the defence of estoppel. However in the matter before me, the change of position defence does

[34] My emphasis by underlining.

not operate and there is no requirement for there to be a restitutionary analysis of detriment. Therefore, the approach should be to revert to estoppel by representation as an evidential concept which is accompanied by the "all or nothing" result. Despite the modern decisions analysed above, the Supreme Court has not yet evolved the law, where these discrete estoppels exist, possibly by reformulating estoppel by representation to move away from its evidential origin towards a more unified doctrine of estoppel. This means that estoppel by representation remains an evidential doctrine, therefore the pro tanto approach in a case where estoppel is the only defence is not appropriate. The defence of estoppel in such circumstances does not require a balancing of equities of the case as may be required, for example, for the defence of change of position.

Claim of Dishonest Assistance by the Bank in the Fraud

174. The Plaintiffs contend, for three reasons, that their claim for dishonest assistance is "*intertwined and inextricably linked*" with the estoppel defence. The first reason is that the facts of the fraud were suspicious enough for the Bank to have been put on inquiry, requiring it to investigate and thereafter pass the information uncovered to the Plaintiffs. The second reason given is that it is submitted that the Court must apply the equitable doctrine and, having regard to the behaviour, state of mind or circumstances of the parties, then consider whether it be unconscionable for the Plaintiffs to be reimbursed. The final reason is that it is claimed that no estoppel may be relied upon as a defence to any claim for

accessory liability for dishonest assistance and that the Bank, due to its dishonesty, could not avail itself of the estoppel defence.

175. There are three elements of a dishonest assistance claim which should be pleaded and must be proved. The first is that there has been a disposal of assets in breach of a trust or fiduciary duty. The second is that the defendant assisted in that breach or disposal. The third, which is the only element in dispute between the parties, is that the defendant assisted the breach of trust dishonestly. Therefore, the key issue is not whether the Bank assisted[35] in the fraud but whether they did so dishonestly.

176. It is accepted by the Plaintiffs that there is no allegation made that an individual employee was an accomplice, but they claim that the forgery occurred because of "*systemic*" or "*structural*" failure by the Bank "*wilfully, alternatively recklessly*" "*shutting its eyes*" when it permitted a number of large payments to Monkton based on forged signatures. The Plaintiffs plead in their Amended Statement of Claim:

> "*146. The Defendant (acting through its employees) wilfully, alternatively recklessly, closed its eyes and ears to the obvious discrepancies and the red flags outlined above in connection with the fraud, and in authorizing multiple fraudulent transactions in the Geneva Account, the Warco Account, and the Bank accounts of other Monkton clients.*

[35] The Bank simply making the relevant payments amounts, in the legal sense, to the element of "assistance" required for a dishonest assistance claim.

147. The Defendant deliberately closed its eyes to obviously forged signatures in respect of the Geneva Account."

At paragraph 147A of the Amended Statement of Claim the Plaintiffs then set out 11 particulars of the dishonesty, cross referencing to a number of transactions which they call "*red flags*" at paragraphs 134-140 in the pleadings.

177. The standard of proof required is the civil standard of proof, the balance of probabilities. It is not an absolute standard. When considering allegations of dishonesty and fraud, a court will naturally require for itself a higher degree of probability than that which it would require when asking if negligence is established. It does not adopt so high a degree as a criminal court, but it still does require a degree of probability commensurate with the occasion and the seriousness of the allegation. The more serious the allegation the more cogent the evidence in support needs to be.

178. The law on what constitutes dishonesty for the purposes of dishonest assistance in the cases before me is conveniently set out in an uncontentious manner by Rose J. in her recent judgment in ***Singularis Holdings Ltd***[36] ***v Daiwa Capital Markets Europe Ltd*** [2017] EWHC 257 (Ch)[37] in which she stated:

> "*143. The test for dishonesty in this context is that set out by the House of Lords in* ***Twinsectra Ltd v Yardley [2002] UKHL 12,***

[36] Singularis was incorporated in the Cayman Islands (originally under the name "Saad Investments Finance Company (No. 7) Limited").
[37] Rose J.'s decision and approach were upheld by the Court of Appeal - ***Singularis Holdings Ltd (in liquidation) v Daiwa Capital Markets Europe Ltd [2018] EWCA Civ 84 (18 December 2017)*** (published 1 February 2018).

***[2002] 2 AC 164**. There Lord Hutton, with whom Lord Slynn of Hadley, Lord Steyn and Lord Hoffmann agreed, described the three possible standards which can be applied to determine whether a person has acted dishonestly. There is a purely subjective standard whereby a person is only regarded as dishonest if he transgresses his own standard of honesty even if that standard is contrary to that of reasonable and honest people; there is the purely objective standard whereby a person acts dishonestly if his conduct is dishonest by ordinary standards of reasonable and honest people, even if he does not realise this, and there is a combined standard: '...which combines an objective test and a subjective test, and which requires that before there can be a finding of dishonesty it must be established that the defendant's conduct was dishonest by the ordinary standards of reasonable and honest people and that he himself realised that by those standards his conduct was dishonest.'*

*144. His Lordship, having considered the test that had been applied by Lord Nicholls of Birkenhead in the earlier case of **Royal Brunei Airlines Snd Bhd v Tan [1995] 2 AC 378** confirmed that dishonesty is a necessary ingredient of accessory liability and that (at para [36]): 'dishonesty requires knowledge by the defendant that what he was doing would be regarded as dishonest by honest people, although he should not escape a finding of dishonesty because he sets his own standards of honesty and does not regard as dishonest what he knows would offend the normally accepted standards of honest conduct.'*

*145. In **Barlow Clowes International Ltd v Eurotrust International Ltd [2005] UKPC 37, [2006] 1 WLR 1476**, Lord Hoffmann considered whether it must be shown that the alleged dishonest assister turned his mind to the ordinary standards of honest behaviour and to whether his conduct fell below those*

standards. He held that it was not necessary. It was only necessary to show that the defendant's knowledge of the transaction rendered his participation contrary to normally acceptable standards of honest conduct. He did not need to be shown to have had reflections about what those normally acceptable standards were.

146. It is clear that wilful blindness will satisfy the test for dishonesty. An honest person does not 'deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless': Royal Brunei, per Lord Nicholls at p389F-G.It is therefore no defence for a defendant to say that he did not realise that he was acting dishonestly: ***Starglade Properties Ltd v Nash [2010] EWCA Civ 1314, [2011] Lloyd's Rep FC 102,at para [32]****and my judgment in* ***Goldtrail Travel Ltd v Aydin [2014] EWHC 1587 at paras [143-145].***

147. Mr Miles [QC, Leading Counsel for Singularis] accepted that Singularis has to show that a particular person within Daiwa was dishonest. There is an important difference between being incompetent – even grossly incompetent – and being dishonest."

180. In ***Stokors SA and Others v IG Markets Ltd and Another*** [2013] EWHC 631 (Comm)[38], Field J., after reviewing the judgments in the above cases mentioned by Rose J. in ***Singularis,*** helpfully set out the following uncontentious principles derived from the authorities:

"(1) It is not necessary for the Court to establish whether or not the defendant considered that he was acting dishonestly. Instead, the defendant's knowledge of the transaction has to be such as to

[38] Although the decision in ***Singularis*** was released after the close of each parties' case and ***Stokors*** was not referred to by the parties, I refer to them as the principles set out therein are uncontentious and the cases neatly summarise the law from the earlier cases.

render his participation contrary to normally acceptable standards of honest conduct.

(2) An honest person does not deliberately close his eyes and ears, or deliberately not ask questions lest he learn something he would rather not know and then proceed regardless where there may be a misapplication of trust assets to the detriment of beneficiaries.

(3) A dishonest state of mind may consist in suspicion combined with a conscious decision not to make inquiries which might result in knowledge.

(4) In a commercial setting dishonesty can be found on the basis of commercially unacceptable conduct

(5) Acting in reckless disregard of others' rights or possible rights can be a tell-tale sign of dishonesty.

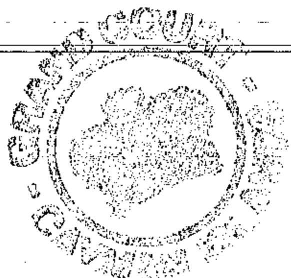
(6) Recklessness is a species of dishonest knowledge and is therefore relevant to the Court's consideration of dishonesty in this context. "Not caring" does not mean "not taking care", rather it means indifference to the truth. The moral obliquity of this position is in the wilful disregard of the importance of truth.

(7) Someone can know, and can certainly suspect, that he is assisting in a misappropriation of money without knowing that the money is held on trust or what a trust means."

181. The Bank contends that the Plaintiffs have pleaded and advanced their dishonest assistance case improperly and that the claim should be dismissed. It was agreed that the Court could exercise its discretion to receive evidence about the dishonesty allegations de bene esse and deal with the Bank's objection taken on the pleadings in this Judgment. The Bank contends that, even if the case is not dismissed on the preliminary issues about the pleadings, the Plaintiffs have failed to produce any evidence to establish that the Bank or any of its employees have

acted in any way dishonestly. The Bank requests that even if there is a dismissal, the Court should still record its views of the allegations of dishonesty advanced by the Plaintiffs.

182. Pleadings are governed by GCR O.18, r.7(1) which provides that facts not evidence must be pleaded:



> *"Subject to the provisions of this rule, and rules 7A, 10, 11 and 12, every pleading must contain, and contain only, a statement in a summary form of the material facts on which the party pleading relies for his claim or defence, as the case may be, but not the evidence by which those facts are to be proved, and the statement must be as brief as the nature of the case admits."*

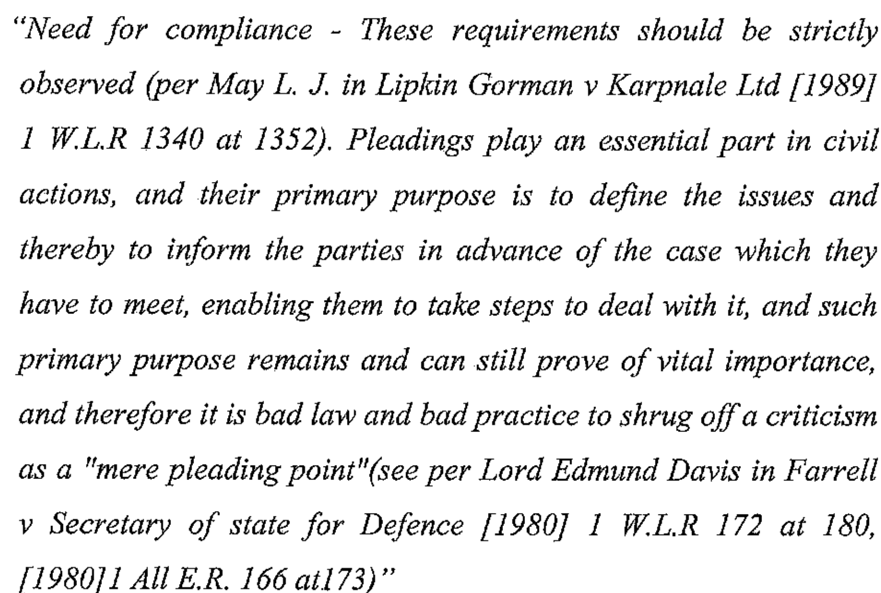
183. Rules 7A, 10 and 11 are not material. Rule 12 deals with particulars of pleading. The relevant part provides:

> *"(1) Every pleading must contain the necessary particulars of any claim, defence or other matter pleaded including, without prejudice to the generality of the foregoing words-*
>
> *(a) particulars of any misrepresentation, fraud, breach of trust, wilful default or undue influence on which the party pleading relies; and*
> *(b) where a party pleading alleges any condition of the mind of any person, whether any disorder or disability of mind or any malice, fraudulent intention or other condition of mind except knowledge, particulars of the facts on which the party relies.*
> *. . . ."*

Thus a statement of claim should contain the material facts, i.e. the facts which are necessary as a matter of law to prove to a plaintiff's case. They should be as concise as the circumstances of the case permit, while containing sufficient detail

to inform a defendant of the nature of that case. The degree of particularity necessary will depend on the particular facts of the case. In a case dealing with a claim of dishonesty the requirement for particularisation is greater as the defence must be able to readily deduce from it what the serious allegations are that it must meet. The pleading must be clear and unequivocal and it is not enough to plead that the Bank was aware or ought to have been aware of DS's actions to establish dishonest assistance.

184. In Supreme Court Practice (1999) Note 18/7/4 at page 314 under the heading "Need for Compliance" with Order 18 it states as follows:



> *"Need for compliance - These requirements should be strictly observed (per May L. J. in Lipkin Gorman v Karpnale Ltd [1989] 1 W.L.R 1340 at 1352). Pleadings play an essential part in civil actions, and their primary purpose is to define the issues and thereby to inform the parties in advance of the case which they have to meet, enabling them to take steps to deal with it, and such primary purpose remains and can still prove of vital importance, and therefore it is bad law and bad practice to shrug off a criticism as a "mere pleading point"(see per Lord Edmund Davis in Farrell v Secretary of state for Defence [1980] 1 W.L.R 172 at 180, [1980]1 All E.R. 166 at173)"*

185. The Bank highlights that, as in this case, where a dishonesty claim and a negligence claim based on similar facts are made, dishonesty must be clearly pleaded first and confined to the fraud, with negligence then being pleaded

separately. Reference is made by the Bank to ***Lipkin v Gorman*** [1989] 1 WLR 1340 where May L.J. stated on page 1351-1352 that:

> *"...first, where fraud or dishonesty is material this must be clearly pleaded—if not explicitly, then in such terms that the reader of the pleading can be left in no reasonable doubt that this is being alleged.*
>
> *Secondly, where an element in the alleged fraud or dishonesty relied on is the other party's knowledge of a given fact or state of affairs, this must be explicitly pleaded. It is ambiguous and thus demurrable, if fraud is relied on, to use the common 'rolled up plea' that a defendant knew or ought to have known a given fact.*[39] *If it is desired to allege and plead fraud and, in the alternative, negligence based upon similar contentions, then the former must be pleaded first and clearly and the relevant part of the plea confined to the fraud. The allegation in negligence can then be pleaded separately and as a true alternative contention."*

186. In its Written Closing Submissions the Bank refers to the history of the Plaintiffs' pleadings. The Bank submits with some force that the claim for dishonest assistance was tagged on to the less serious allegations. In this regard, I note that in the initial Statement of Claim, found after the allegations of breach of contract and negligence were pleaded, only 9 of the 162 paragraphs related to the issue, and they contained minimal particularisation of the dishonesty alleged.

187. The Plaintiffs failed to adequately particularise, in the dishonest assistance section of the pleading, its reference in paragraph 146 to "*authorising multiple fraudulent*

[39] See paragraph 192.

transactions" and "*the Bank accounts of other Monkton clients*" and its reference in paragraph 147 to "*obviously forged signatures.*" Paragraph 146 refers to "*obvious discrepancies.... outlined earlier*" (in other non-dishonest assistance sections of the pleading).

188. At paragraph 146 of the Statement of Claim the Plaintiffs also refer back to what are termed "*red flags*" which are pleaded under the heading "Particulars of Negligence/Breaches of Duty" in the part of the pleading dealing with the negligence allegations. Eight of the nine paragraphs in the "Particulars of Red Flags" section use the phrase "*knew or ought to have known*", "*a rolled up plea*" which incurred the disapproval of May LJ on page 1352 in ***Lipkin v Gorman***.[40]

189. The dishonesty allegation, which it appears was being based on the similar and earlier contentions relied upon for the alternative negligence claim, was not pleaded first, nor could it be said that the negligence claim was thereafter truly separately pleaded. No individual employee was identified by name or position in the Bank as conducting themselves dishonestly.

190. In light of the above, if the initial version of the Statement of Claim had been the version of the pleading before this Court, it would have been found to have failed to provide adequate particulars and to adequately plead dishonest conduct.

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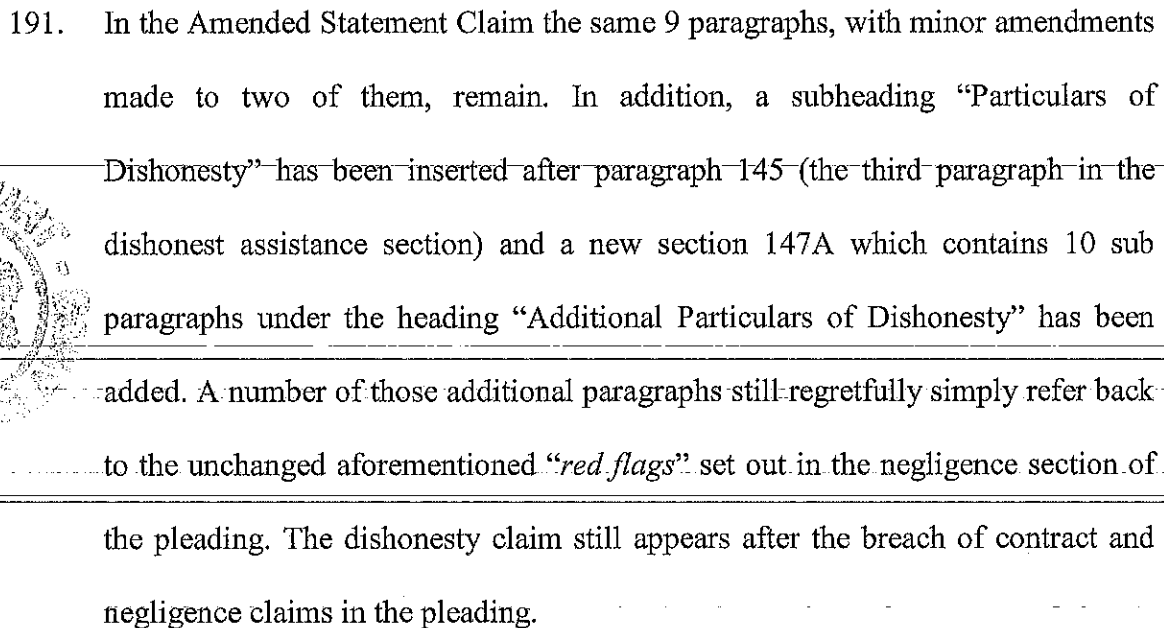
[40] See paragraph 184 herein.



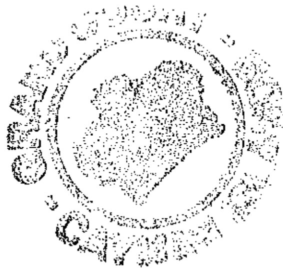
191. In the Amended Statement Claim the same 9 paragraphs, with minor amendments made to two of them, remain. In addition, a subheading "Particulars of Dishonesty" has been inserted after paragraph 145 (the third paragraph in the dishonest assistance section) and a new section 147A which contains 10 sub paragraphs under the heading "Additional Particulars of Dishonesty" has been added. A number of those additional paragraphs still regretfully simply refer back to the unchanged aforementioned "*red flags*" set out in the negligence section of the pleading. The dishonesty claim still appears after the breach of contract and negligence claims in the pleading.

192. The Bank contends that the dishonest assistance claim is not clearly pleaded in the Amended Statement of Claim and that there remains the overlap with the other allegations. The Bank highlight the following content in the amended pleading to be vague and unparticularised:

(i) paragraph 147A(iv) - "*such inquiries and inspections as might reasonably have been made .... "*;

(ii) paragraph 147A(vii) - "*failing to investigate ... or to make appropriate inquiries ...*" at

(v) paragraph 147A(viii) -"*the Defendant's conduct amounted to commercially unacceptable conduct in the context of corporate banking and in the circumstances of the red flags ... "*; and



(vi) paragraph 147A(ix) - *"failed to comply with its own internal policy which represented the minimum standard of reasonable and honest conduct the Defendant knew to be required ... ."*

193. The rolled-up plea form at paragraphs 134-140 deemed inappropriate by May L.J. remains and similar terminology such as "*ought reasonably*" and "*might reasonably*" again appears in the paragraph 147A additional particulars.

194. In the Amended Statement of Claim, again, no individual employee was identified by name or even by position in the Bank as conducting themselves dishonestly or as having relevant knowledge. The Plaintiffs confirm at paragraph 226 of their Closing Written Submissions that they:

> "*never alleged in these proceedings that any one individual (Bank) employee was an actual accomplice to (DS) in his fraud with full knowledge of the forgeries. (Mr. Ritter's) position has always been that there was a "systemic" or "structural" failure by the Bank ...."*

The Plaintiffs contend that they need not identify specific individuals or any:

> "*actual culprit employees at the Bank who were wilfully shutting their eyes and ears to the obvious fraud in proving dishonest assistance, in light of the fact such misconduct would always have been in the course of employment at the Bank for which it is trite law, Butterfield would be vicariously liable."*

195. Mr. Skinner stated that the majority of the transfer requests came via facsimile in the form of a letter or a standard Request for Wire Transfer Form. Due to the passage of time, Mr. Skinner indicated that he could not give details about the members of staff who handled the transfers or exact details about the process for each transfer process followed in each transfer. I therefore accept that the Plaintiffs may have difficulty naming the precise member of staff who they contend acted dishonestly. However, this did not prevent them from pleading or later clearly specifying in their evidence, which particular individual(s), identified by their post, was culpable.

196. In ***Publishers Representatives Limited and Lee Sku Kee v UBS (Cayman Islands Limited*** [2000 CILR 473] Sanderson J. considered the approach taken in ***Royal Brunei Airlines*** to the issue of what constitutes dishonesty. The Court was dealing with an application to strike out portions of a statement of claim in which the Plaintiffs were seeking damages for alleged fraud or dishonesty and negligence from the defendant bank. The bank had been the trustee of a pension fund for the second plaintiff's employees, but when the bank retired from this role it was replaced by a former trust officer of the bank who had been investigated when employed with them for fraud in relation to trust funds held by the bank. The plaintiffs contended that the bank should have informed them about the former employee's fraud and supervised his handling of the funds. The defendants did not plead that any one bank employee was dishonest, but

contended that the company was dishonest for failing to disclose its knowledge to the plaintiffs. Sanderson J at page 486 stated :

> *"I accept UBS's submission that a company has no mind or will of its own and that the doctrine of directing mind and will attributes to the company the mind and will of the natural person or persons who manage and control its actions: see **R v Ghosh** (.) and **El Ajou v Dollar Land Holdings PLC** (.). I also accept (counsel for the defendant's) submissions that combining innocent acts of individuals cannot create a fraudulent or dishonest act in a company."*

Sanderson J. then went on to say

> *"However, in this case it is not known who made the decision not to disclose to Publishers the information that UBS had. The allegation of dishonest conduct by the company has been pleaded and particularized. That is, Publishers rely on the knowledge of Albert Good. He had the knowledge of the conduct of Mr. Randall. His knowledge was therefore the knowledge of UBS. It has been alleged in the pleadings that the person or persons at UBS who were the directing mind and will of UBS made the decision not to disclose what it knew to Publishers. It is not necessary to plead who made the decision if the plaintiffs do not know. To require the plaintiffs to guess would be irresponsible and unfair to both parties.*
>
> *Publishers acknowledge that at trial they will have to prove that the directing mind and will of UBS knew of Mr Randall's conduct and should have done something more than it did. Publisher's claim should not be struck at the pleadings stage because they are unable to say who at UBS made the decision."*

197. ***UBS*** can be distinguished as the Court was reviewing pleadings in which the dishonest conduct appears to have been appropriately pleaded, unlike in the matter before me. In ***UBS*** a bank employee was identified as having direct knowledge of the fraudulent conduct of the employee which the "*persons who were the directing mind and will*" of UBS made the decision not to disclose to the first plaintiff.

198. In cases of dishonest assistance against a corporate entity, a particular individual (or particular individuals) must be identified as having acted dishonestly given the fact that, although a company has legal personality and capacity, it functions through human agents. Therefore the Statement of Claim must identify and particularise what the defendant did to assist in the breaches of fiduciary duty or trust, how the assistance caused, contributed or resulted in the Plaintiff's loss and how the defendant is alleged to have acted dishonestly in assisting the main perpetrator. The Bank rightly highlight the requirement that it may be permissible not to identify the relevant dishonest individual(s), at the stage of pleading the case, if the plaintiff was unaware, as in this case, of their identity, so long as the plaintiff otherwise properly pleads and particularises the dishonest conduct and identifies an individual employee by name or even by post with relevant knowledge.

199. The Plaintiffs have failed in the matter before me to identify in the pleadings or at trial any individual(s) either by name or by post with any relevant knowledge of

the fraud or who acted dishonestly. Due the inadequacy of the particularisation, the Bank and the Court are unable to identify, even if not by name(s) but by role(s)/position(s) in the Bank, who it is alleged has been dishonest or who should have had knowledge of the fraudulent conduct. In addition, the Plaintiffs have failed to plead the dishonesty in the appropriate manner commended by May L.J. in ***Lipkin***.[41]

200. As dishonesty is a serious allegation it is not to be pleaded lightly. There is merit in the Bank's submission at paragraph 445 of its written closing submissions that:

> *"Re-reading paragraphs 146 to 147A of the Statement of Claim clearly shows the vague and general terms in which the majority of the so-called "particulars" have been provided. This is improper both as the Bank and its employees are entitled, when being accused of having acted dishonestly, of knowing more than just in general terms how they are being alleged to have been dishonest. They are entitled to know, pursuant to the Grand Court Rules and as a matter of basic procedural fairness, the particular and specific basis on which the Plaintiffs are asking the Court to make dishonesty findings against them, findings which clearly have very serious ramifications for any individual and business, in particular a highly reputable, regulated Bank, such as the Defendant."*

201. Accordingly as the above principles of pleadings must be strictly observed, and in the absence of any identified person at the bank who has acted dishonestly, the pleadings would not permit the Court to make a finding of dishonesty and I dismiss that claim.

[41] See paragraphs 181-194 above.

202. In case I am wrong in reaching this conclusion I have felt it appropriate when reviewing the facts earlier in this Judgment to address whether the allegations concerning the Bank's handling of the transactions made by the Plaintiffs were sufficient for them to prove a finding of the element of dishonesty required for dishonest assistance to be made out, even based on an allegation of a Bank's employees being reckless or closing their eyes and ears. Having regard to the principles set out in paragraphs 178-184 above and my earlier comments and findings on the evidence, I do not find that the Plaintiffs have provided evidence sufficient to prove such a serious allegation. I accept that, armed with hindsight and with the advantage of the later gained knowledge (unknown at the time by anyone in the Bank) the Bank, which I accept is a Bank with a specialised department serving commercial clients, accepts that some additional enquiries maybe could have been made, but this does not make the Bank dishonest when applying the tests set out in the cases analysed herein. There is no evidence that the Bank, as is pleaded, deliberately allowed transactions that were fraudulent to be processed.

Costs

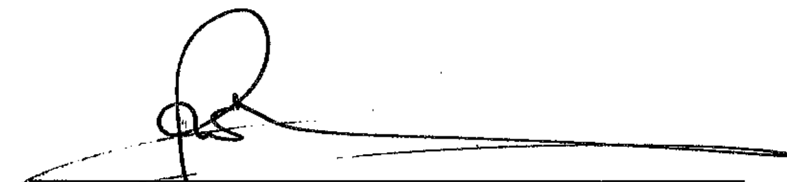
203. As the Bank has been the successful party in this matter, as costs ordinarily follow the event, I am presently minded to make an order for the Plaintiffs to pay the Banks costs. Having reviewed the manner in which the case has been argued, I am presently minded to make the order on the standard basis. However, if either party wishes be heard on the issue of costs they should, within 21 days of the

circulation of the perfected version of this judgment, file and serve a Summons seeking a costs hearing.

Closing Remarks

204. In reaching this conclusion I have considered the evidence and authorities contained in the large number of files. I have also considered the Plaintiffs 21 page Opening Written Submissions and their 72 page Closing Written Submissions (including schedules). I have also considered the Bank's Opening Written Submissions (with schedules) totalling 103 pages and it's Closing Written Submission (with schedules) running to 163 pages.

205. Last but not least, I thank Counsel for their impressive and prodigious contribution to these proceedings in which many complex issues required their attention and for their and their clients' extreme patience in awaiting this decision.



THE HON. MR. JUSTICE RICHARD WILLIAMS
JUDGE OF THE GRAND COURT

a

Brown and another v Bennett and others

COURT OF APPEAL, CIVIL DIVISION
MORRITT, ALDOUS AND HUTCHISON LJJ
11 NOVEMBER, 1 DECEMBER 1998

b

Winding up – Constructive trusteeship – Sale of business by receivers – Former owners of business alleged breach of fiduciary duty and conspiracy in driving business into receivership – Whether purchaser of business and company secretary liable as constructive trustees for knowing receipt of trust property or knowing assistance in breach of trust.

c

The plaintiffs were shareholders in and directors of a company, Pinecord Ltd, which traded under the name of Oasis. In 1988 the first and second defendants became shareholders in and directors of the company. The seventh defendant, S, was the company secretary. Between 1988 and 1990 further investments were made in the company which had the effect of
d
reducing the plaintiffs' interest to a minority interest and in 1991 the plaintiffs ceased to be directors. The company then went into administrative receivership and the receivers sold its business to a new company, the 11th defendant, Oasis, in which the first, second and fourth defendants had a substantial stake. Pinecord went into liquidation and the liquidators assigned
e
its causes of action to the plaintiffs. The plaintiffs took proceedings claiming that Oasis obtained the business of the company in consequence of a dishonest and fraudulent design, of which it had notice at the time of such receipt, and in which it assisted with knowledge. Accordingly it was liable as a constructive trustee and as a co-conspirator with the other defendants in the action. The plaintiffs alleged that S was also involved in the dishonest
f
design and liable both for assisting in it and as a co-conspirator. Rattee J struck out the claims against Oasis and the claim against S as a constructive trustee. The plaintiffs appealed.

Held – (1) The allegation of knowing receipt against Oasis was that it
g
purchased the assets with knowledge of all the dishonest breaches of fiduciary duty alleged against the defendant directors, but it was quite plain as a matter of principle that the receipt had to be the direct consequence of the alleged breach of trust or fiduciary duty of which the recipient was said to have notice whereas in this case Oasis acquired the property bone fide under a purchase with independent fiduciary sellers, namely the
h
administrative receivers. Accordingly the judge was right to strike out the allegation of knowing receipt on the grounds that Oasis did not receive any trust property as a result of a breach of trust.

El Ajou v Dollar Land Holdings plc [1994] 1 BCLC 464, [1994] 2 All ER 685 applied.

i
(2) In relation to the claim of knowing assistance, it was arguable (contrary to the view of the judge) that a breach of directors' fiduciary duties in relation to management was sufficient to found accessory liability and that there did not have to be a breach of trust in relation to property. However

the judge's judgment was upheld on the second ground he gave which was that Oasis did not assist in the breaches of duty because all of them were complete before its incorporation or, at least, before it acquired the business of the company. The claim for conspiracy against Oasis fell with the claim for knowing assistance. Accordingly the plaintiffs' appeal against the striking out of the claims against Oasis was dismissed.

Royal Brunei Airlines Sdn Bhd v Tan [1995] 3 All ER 97, [1995] 2 AC 378 considered.

(3) The judge considered that the allegations against S did not adequately particularise the cause of action for knowing assistance of which dishonesty was a necessary ingredient. The plaintiffs would be given leave to amend to make it clear that dishonesty was alleged against S but subject to that their appeal was dismissed.

Cases referred to in judgment

Baden v Société Générale pour Favoriser le Développement du Commerce et de l'Industrie en France SA [1983] BCLC 325, [1992] 4 All ER 161, [1993] 1 WLR 509.

Barnes v Addy (1874) LR 9 Ch App 244.

Cook v Deeks [1916] 1 AC 554, HL.

El Ajou v Dollar Land Holdings plc [1994] 1 BCLC 464, [1994] 2 All ER 685, CA.

Montagu's Settlement Trusts, Re [1992] 4 All ER 308, [1987] Ch 264.

Royal Brunei Airlines Sdn Bhd v Tan [1995] 3 All ER 97, [1995] 2 AC 378, [1995] 3 WLR 64, PC.

Appeal

The plaintiffs, Mr and Mrs Brown, appealed with the leave of Robert Walker LJ from the order of Rattee J made on 25 November 1997 ([1998] 2 BCLC 97) striking out the plaintiffs' claim against the 11th defendant, Oasis Stores plc, and part of the claim against the seventh defendant, Mr Sarson. The facts are set out in the judgment of Morritt LJ.

David Oliver QC and *Nicholas Asprey* (instructed by *Abrahamson & Associates*) for the appellants.

Barbara Dohmann QC and *Robert Anderson* (instructed by *Berwin Leighton*) for the respondents.

Cur adv vult

1 December 1998. The following judgments were delivered.

MORRITT LJ. This appeal is brought with the leave of Robert Walker LJ by the plaintiffs, Mr and Mrs Brown, from the order of Rattee J made on 25 November 1997 ([1998] 2 BCLC 97). By that order the judge struck out the whole of the claim of Mr and Mrs Brown against the 11th defendant, Oasis Stores, now a plc, and part of the claim against the seventh defendant, Mr Sarson.

In the action Mr and Mrs Brown sue as minority shareholders in and as the assignees of the 12th defendant, Pinecord Ltd (the company), the assignment having been executed by the liquidator. The company formerly

traded under the name of Oasis as a retailer and wholesaler of ladies clothes and fashion accessories and, in addition, franchised the name for use by *a* others in connection with their own products.

The company went into administrative receivership on 24 January 1991, sold its business to a new company, the 11th defendant Oasis, on 7 March 1991 and went into insolvent liquidation on 9 June 1993.

In these proceedings the Browns claim that Oasis obtained the business of *b* the company in consequence of a dishonest and fraudulent design, of which it had notice at the time of such receipt, and in which it assisted with knowledge. The Browns allege that Oasis is accordingly liable under both limbs of the well-known case of *Barnes v Addy* (1874) LR 9 Ch App 244, and as a co-conspirator with the other defendants in the action. Rattee J *c* considered that all such claims were obviously unfounded and struck them out. As I have indicated, Mr and Mrs Brown now appeal.

The seventh defendant, Mr Sarson, became the secretary of the company on 10 August 1988. Mr and Mrs Brown allege that he was also involved in the dishonest design to which I have already referred, and liable to Mr and Mrs Brown both for assisting in it and as a co-conspirator. Rattee J struck *d* out the first but not the second allegation. The Browns appeal in respect of the first, but there is no cross-appeal in respect of the second.

It is necessary to refer to the underlying facts of the case in rather more detail. Down to 4 August 1988 Mr and Mrs Brown were the only shareholders in the company and, together with the fifth defendant, Mr *e* Evans, and the sixth defendant, Mr Kane, the only directors. On 4 August 1988 there was completed with some modifications an agreement which had been made on 19 February 1988, whereby the first and second defendants, Morris and Michael Bennett, became directors of the company and acquired a one per cent shareholding in the company and an option to acquire a *f* further 39% of the company, in consideration of a loan of £500,000 made by a finance company owned by them known as Camion.

On 20 March 1989 there was a formal agreement between the company and Camion relating to further loans which had been made, aggregating some £630,000; and a formal option agreement, replacing all the earlier agreements, whereby options were conferred on Morris and Michael Bennett *g* to acquire 45% of the shares in the company.

On 15 September 1989 the eighth to tenth defendants, to which I shall refer as 'APA', a venture capital group, subscribed £1m for shares in the company. The loans made to the company by Camion were repaid and the Bennetts exercised their options to acquire shares in the company, thereby *h* reducing the percentage interest of Mr and Mrs Brown to 43.2%. Then on 28 March 1990 the company raised £1m by a rights and convertible loan stock issue.

The Browns ceased to be directors of the company on 19 July 1990. They allege that they were forced to resign by the Bennetts' refusal to implement *i* economies which they had said were necessary, such economies necessitating a reduction in the administrative duties of the Bennetts. Whether that is so or not, we have to assume it for present purposes. Its only relevance, I think, is that that is why the Browns ceased to be directors on 19 July 1990. Of more

importance is the fact that on 31 October 1990 the loan stock was converted into shares in the company, and thereafter the interest of the Browns was reduced yet further, to 33.8%.

As I have indicated, the company went into administrative receivership on 24 January 1991. Its then directors were the Bennetts, the third defendant, Mr Freedman (said to be a nominee of APA), the fourth defendant, Mr Scott, and Mr Evans and Mr Kane.

The receivers then advertised the business of the company as being for sale. A number of offers were received. An offer was received from the plaintiffs, Mr and Mrs Brown. An offer was also received from the Bennetts, and that was accepted by the receivers on 13 February 1991, subject to contract and to adequate finance being apparently forthcoming. Following that acceptance, on 21 February 1991 the Bennetts acquired from company registration agents the outstanding issued shares in Oasis. They then and there, on that date, became the only two directors of Oasis.

Following the acceptance of their offer on 13 February, and more so after the acquisition of Oasis on 21 February, negotiations took place between the Bennetts on the one hand and outside investors on the other, formed together for the purpose under the aegis of a company called Tuneclass Ltd. Negotiations were directed to funding Oasis for the purpose of the acquisition of the business of the company and for structuring that acquisition by Oasis. Thus it was that on 7 March 1991 the share capital of Oasis was increased to £1.1m, of which about 49% was issued to the Bennetts and Mr Scott, and the rest to Tuneclass Ltd. Oasis bought the business of the company through the agency of the administrative receivers for £1.5m.

As I have indicated, the company went into insolvent liquidation on 9 June 1993. By contrast, Oasis prospered and on 28 June 1995 its shares were floated on the Stock Exchange, according to the statement of claim at a considerable profit to the Bennetts. The writ in the action was issued on 27 March 1996, followed by the assignment of causes of action by the liquidators to the Browns on 19 March in the same year.

Applications to strike out the statement of claim were made by Mr Sarson in relation to the claims against him on 20 January 1997 and by Oasis in respect of the claims against it on 23 October 1997. In the meantime, on 13 March 1997, the plaintiffs had sought leave to amend the statement of claim in order to put it in a rather more digestible form. These matters came before Rattee J at the end of July 1997, when he gave certain interim directions about the production of a further edition of the statement of claim. The actual summonses for leave to amend and to strike out came before him on 25 November. As I have indicated, he did strike out the whole of the claim against Oasis and part of the claim against Mr Sarson.

The application for leave to appeal came before Robert Walker LJ who, in granting leave to appeal, expressed the view that the judge's decision raised serious issues as to the limits of proprietary and restitutionary remedies. That then is the background to the action.

I will deal first with the claims against Oasis. The foundation to these claims lies in the claim against the Bennetts, which is summarised in para 47 of the amended statement of claim. It is not necessary, I think, to read it verbatim. The effect of that allegation is that the Bennetts either intentionally

or recklessly put the company into such financial difficulties that they might increase their share of the equity as a condition for extricating the company from the difficulties they had caused, and/or in order to put the company into administrative receivership with a view thereafter to buying the business from the receiver for the benefit of themselves and their associates.

The conduct relied on on the part of the Bennetts and others is that alleged in paras 48 to 53 of the amended statement of claim. As I have indicated, that conduct is alleged to have been fraudulent. The aspects of the conduct relied on are threats in October 1988 to call in the Camion loans, the fact that between February and July 1990 the Bennetts maintained the head office expenses of the company at a level in excess of the company's gross profits and refused to make the necessary economies, the fact that the Bennetts ultimately caused the company to move its head office, thereby incurring further costs whilst still paying the rent and excessive outgoings in respect of the old one and, finally but not by any means least, planning the phoenix operation by which the business of the company was acquired by Oasis for the benefit of the Bennetts and their associates Mr Scott, Mr Evans and Mr Sarson.

It is against that background that the claim against Oasis is made in para 91 of the amended statement of claim. That alleges:

> 'Oasis purchased from the Administrative Receivers the goodwill and assets of the business by the Agreement dated 7 March 1991 pleaded in paragraph 34 above. At that date Oasis had knowledge of all the aforesaid breaches of fiduciary duty pleaded in paragraphs 48 to 53 hereof and moreover knew that such breaches of duty were dishonest, in that the knowledge of the Bennetts and/or of Mr Scott in those matters is to be imputed to Oasis and its directors.
>
> By such action Oasis participated in and/or assisted the Bennetts to commit the breaches of fiduciary duty pleaded in paragraph 53 above.
>
> Reference will be made to paragraphs 78 to 90 of the Particulars to support this allegation.'

Then in para 92 the Browns allege a conspiracy to which Oasis was a party in these terms:

> 'On or shortly after 2 January 1991 Oasis agreed with the Bennetts, Mr Freedman, Mr Scott, Mr Evans, Mr Sarson and/or APA to assist the Bennetts in the acquisition of the business for themselves by causing the Company to go into receivership and buying the business back from the receiver with a view to each of the said parties participating in the business (via Oasis) when so purchased.
>
> Such agreement was an unlawful conspiracy in that it was an agreement to injure the Company and/or the Plaintiffs as shareholders in the Company by unlawful means namely by committing the breaches of fiduciary duty pleaded in [and then the various paragraph numbers are given].

> Reference will be made to paragraphs 78 to 90 of the Particulars to support this allegation. The participation of the Bennetts, Mr Freedman, Mr Scott, Mr Evans, Mr Sarson and APA in the conspiracy is pleaded at paragraphs [and then various other paragraphs are set out].'

a

The conclusion alleged in para 93 of the amended statement of claim is in these terms:

b

> 'As a result of the aforesaid breaches of fiduciary duty and/or conspiracies the Company went into receivership and the business was purchased from the Administrative Receivers by Oasis as pleaded in paragraphs 33 and 34 hereof, and the Bennetts, Mr Scott, Mr Evans and Mr Sarson have since participated (via Oasis) in the management and/or equity of the business and/or as an employee in the business.'

c

Then there is a reference to certain further particulars in specified paragraphs.

It is apparent from those paragraphs, from the judgment of the judge and the skeleton argument produced helpfully by counsel for Mr and Mrs Brown before us, that the causes of action relied upon against Oasis are three in number. First of all, there is what is labelled 'knowing receipt'; that is the first limb of the proposition established by *Barnes v Addy* (1874) LR 9 Ch App 244. Secondly, there is 'knowing assistance', that is to say the second limb of the proposition established by *Barnes v Addy*. Thirdly, there is common law conspiracy. I propose to deal with each of those three in turn.

d

The allegation of knowing receipt, as set out in para 91, is that Oasis purchased the assets with knowledge of all the dishonest breaches of fiduciary duty alleged by Mr and Mrs Brown. This was rejected by the judge in the passage in his judgment where he said ([1998] 2 BCLC 97 at 104):

e

> 'In the present case the statement of claim pleads no breach of trust, as opposed to a breach of fiduciary duty owed by a director to his company. The only relevant trust suggested at any stage by Mr Oliver was the trust to which a director has been said to be subject in relation to a company's property under the director's control (see 7(1) *Halsbury's Laws* (4th edn, 1996 reissue) para 591). There is no allegation in the amended statement of claim that any of the directors of the company committed any breach of trust in relation to the company's property. Not surprisingly it is not alleged that the sale of the company's assets to Oasis was a breach of any trust in relation to those assets. It was carried out for full value by independent receivers. It cannot therefore be said, consistently with the proposed pleading, that Oasis received any trust property as a result of a breach of trust, so as to have become a constructive trustee of it under the "knowing receipt" limb of the *Barnes v Addy* formulation.'

f

g

h

Before us Mr Oliver frankly accepted that he could not and did not allege that the acquisition of the remains of the business by Oasis from the administrative receivers was itself a breach of trust. He contended that the judge was wrong because, he said, it was plain that Oasis had the requisite knowledge through the Bennetts as from 21 February 1991 that the breaches

i

of fiduciary duty alleged against the Bennetts gave rise to the sale to Oasis on 7 March, without which it would not have occurred, so that (and this, as I understood it, was the alleged consequence) there was a knowing receipt within the principle because Oasis could not in those circumstances be a bona fide purchaser without notice.

For the Bennetts it was alleged by a respondent's notice that the knowing receipt claim had not been adequately pleaded, but in the circumstances we heard no argument on it.

The knowing receipt claim is dealt with in a large number of authorities over many years. I take as a paradigm example of its proper expression the passage in the judgment of Hoffmann LJ in *El Ajou v Dollar Land Holdings plc* [1994] 1 BCLC 464, [1994] 2 All ER 685. It is unnecessary to refer to the facts of that case. It is sufficient to go to the commencement of Hoffmann LJ's judgment where he said ([1994] 1 BCLC 464 at 478, [1994] 2 All ER 685 at 700):

> 'This is a claim to enforce a constructive trust on the basis of knowing receipt. For this purpose the plaintiff must show, first, a disposal of his assets in breach of fiduciary duty; secondly, the beneficial receipt by the defendant of assets which are traceable as representing the assets of the plaintiff; and thirdly, knowledge on the part of the defendant that the assets he received are traceable to a breach of fiduciary duty.'

It is in my view quite plain from that statement of principle (and there are many other similar ones in the books) that the receipt must be the direct consequence of the alleged breach of trust or fiduciary duty of which the recipient is said to have notice.

The matter, I think, can be tested in this way. Let us assume a mansion house vested in trustees. The trustees fail to perform their fiduciary duties and allow it to fall into appalling disrepair. They are then replaced by other trustees who decide that the matter has gone too far and decide to sell the property. They sell the property to a next-door neighbour, who for the previous 40 years has watched the mansion house falling into disrepair. The sale by the new trustees to the neighbour is entirely proper, at a proper price. The neighbour unquestionably has notice of the previous breaches of duty, because he watched them happen, but the breaches of duty did not give rise to any receipt by the neighbour; the neighbour was not in any way responsible for them and he paid the full value for what he received from the new trustees when he bought. I can see no reason why in those circumstances there should be any constructive trust liability imposed upon the neighbour merely because he watched the house fall into disrepair before he was enabled to buy it.

Mr Oliver, on the part of the plaintiffs, counters the suggestion that the proposition is as narrow as Hoffmann LJ expressed it in *El Ajou*. He makes three points. First he said that Hoffmann LJ was not seeking to define the outer limits of the principle. I agree, but he was expressing the principle in the conventional terms in which it has been expressed on countless occasions over countless years, and no one was able to produce any authority to

indicate that the method of expression was not in fact properly used to confine the principle to cases where the property is conveyed in breach of trust to the knowing recipient. a

Second, he referred to the decision of Peter Gibson J in *Baden v Société Générale pour Favoriser le Développement du Commerce et de l'Industrie en France SA* [1983] BCLC 325 at 403, [1993] 1 WLR 509 at 571, where Peter Gibson J set out (para 236):

b

> 'The first category of "Knowing receipt or dealing" is described in [*Snell's Principles of Equity*] at 194 as follows: "A person receiving property which is subject to a trust . . . becomes a constructive trustee if he falls within either of two heads, namely: (i) that he received trust property with actual or constructive notice that it was trust property and that the transfer to him was a breach of trust".' c

I omit the rest as being irrelevant for present purposes. Then he continued (para 237):

> 'I admit to doubt as to whether the bounds of this category might not d be drawn too narrowly in *Snell*. For example, why should a person who, having received trust property knowing it to be such but without notice of a breach of trust because there was none, subsequently deals with the property in a manner inconsistent with the trust not be a constructive trustee within the "knowing receipt or dealing" category.'

e

Mr Oliver relies on that passage as indicating that the confinement of the principle suggested by Hoffmann LJ is not in fact right because it is envisaged by Peter Gibson J that there is a liability for knowing receipt in the circumstances there postulated. That may be so, but it does not appear to me to help in deciding this case. What Peter Gibson J was contemplating was the f receipt by a volunteer who obtains notice of the trust before he distributes the trust property wherever he wishes. In those circumstances the notice that he subsequently receives imposes upon him the constructive trust because his original receipt was voluntary. It says nothing about the imposition of a constructive trust and the application of the knowing receipt principle to one who, as is admitted in this case, acquired the property bone fide under a g purchase with independent fiduciary sellers, namely the administrative receivers.

Finally Mr Oliver refers to the corporate opportunity cases. Those are cases in which a beneficial commercial opportunity comes the company's way and forms knowledge owned or possessed by the directors as agents for the company. Those directors then seek to use that knowledge or h opportunity for themselves and are subsequently held to be constructive trustees of it and of its fruits for the company whence they took it. A good example of that is *Cook v Deeks* [1916] 1 AC 554. But again, it seems to me in cases such as that that there is a distribution or a disposal of the property of the company in breach of trust. At stage 1 the director holds that property i as agent for the company. At stage 2 he purports to hold it himself beneficially. If that were to be the case, it would involve a distribution of the property by himself to himself in breach of trust, and a dishonest breach of

trust at that. I am wholly unconvinced that the proposition as established by Hoffmann LJ is in any sense too narrowly drawn. It seems to me in this case that the judge was entirely right to strike out the allegation of knowing receipt on the grounds on which he did.

I pass then to the question of knowing assistance. This is again raised in para 91 of the amended statement of claim, which I have already read. It is alleged that by such action (that is to say the purchase of the business) Oasis participated in and/or assisted the Bennetts to commit the breaches of duty. This claim was rejected by Rattee J for reasons apparent from the following passage of his judgment ([1998] 2 BCLC 97 at 104):

> 'As I have already said, the burden of the plaintiffs' complaint in this case is that the defendant directors of the company acted in breach of their fiduciary duty to manage the affairs of the company in the best interest of the company, in that they, for an ulterior motive, so managed such affairs as to put the company under unnecessary financial pressure, with a view to forcing it into receivership. In my judgment, to apply the "knowing assistance" limb of the *Barnes v Addy* formulation of constructive trusteeship to a case of assistance, not in a breach of trust affecting property, but in a breach of a director's duty in relation to the management of a company's affairs, would represent an extension of that head of constructive trusteeship beyond the limits so far recognised by the court.'

As was pointed out by Lord Nicholls in delivering the advice of the Privy Council in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 3 All ER 97 at 99, [1995] 2 AC 378 at 382:

> 'Liability as an accessory [ie a constructive trustee for knowing assistance] . . . is a form of secondary liability in the sense that it only arises where there has been a breach of trust.'

However, Mr Oliver argued that this head of liability as a constructive trustee should extend to a case of knowing dishonest assistance in any breach of fiduciary duty, and not only to assistance in a breach of trust in relation to property. If a person dishonestly assists another to commit a breach of fiduciary duty, he should in equity be liable to compensate the person to whom the duty was owed for any loss caused by its breach. I see force in such argument, but it does not seem to me that it can avail the plaintiffs in the present case. The breach of duty which, if the plaintiffs are right, caused the company damage, was the deliberate or reckless management of the affairs of the company by the defendant directors in a manner calculated to put the company under unnecessary financial pressure, to the point where it was forced into receivership. It is impossible on the undisputed facts to say that Oasis, which had no connection with the directors of the company until after the appointment of the receivers, assisted in any such breach of the directors' duties. The breach and the resultant damage to the company were complete before Oasis came on the scene.

Rattee J then proceeded to consider an argument by Mr Oliver to the effect that the conclusion to which he had prima facie come was manifestly inequitable. After describing the argument, the judge said ([1998] 2 BCLC 97 at 105):

> 'I do not accept this on the undisputed facts of this case. There are numerous people interested in Oasis other than the defendants. Oasis's profitable running of the business formerly run by the company has been achieved in part as a result of the financing of Oasis by its other major shareholder, Tuneclass Ltd. I see no reason in equity why the company, or the plaintiffs as its assignees, should be entitled to that profit, as opposed to being compensated for any loss, including any loss of future profits, caused to the company by the alleged breach of duty by the director defendants in unnecessarily bringing the company to a state of financial collapse. This compensation will be payable by the defendants who were parties to such breach of duty, if the plaintiffs can prove their case. In my judgment there is no principle of law or equity which makes such compensation recoverable from Oasis, which played no part whatever in the directors' alleged breach of duty in the management of the affairs of the company before it went into receivership. By the time Oasis came on to the scene that management was no longer in the hands of the defendant directors. It was in the hands of the receivers. Any breach of duty by the directors was by then in the past.'

It can be seen from the first of the passages which I quoted from Rattee J's judgment that his conclusion on the question of liability for knowing assistance appears to be based on two reasons. The first appears to be that, in the view of the judge, there must be a breach of trust in relation to property, a breach of duty in relation to management not being sufficient. The second is that Oasis did not assist in the breaches of duty because all of them were complete before the time of its incorporation or, at least, before the time at which it acquired the business of the property.

Mr Oliver, on behalf of Mr and Mrs Brown, contends that the judge was wrong on both counts. He submits that on authority and on principle, a breach of a fiduciary obligation is equivalent for all purposes to a breach of trust when a fiduciary obligation is one imposed upon a director of the company in relation to the management of the company's property. He submits, secondly, that Oasis's purchase assisted in the plan as alleged to have been concocted by the Bennetts because it was its purpose and ultimate culmination.

For Oasis, Miss Dohmann sought to justify the judge's first reason. She submitted that when one analyses *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 3 All ER 97, [1995] 2 AC 378, it can be seen that in fact there was a disposal of the company's property and, therefore, a disposition of the property to which the knowing assistor could be secondarily liable. She says that it would be contrary to all principle to enable a constructive trust to be imposed upon a third party in relation to a loss which was in fact sustained by a breach of duty on the part of directors without any corresponding benefit on the part of ascertainable third parties.

It is sufficient for present purposes for me to say that it does seem to me that there is here an arguable point, which in the circumstances of the case it is not necessary to decide. I would not therefore uphold the judge's conclusion on knowing assistance on the first point. I recognise that to be arguable, and were that the only point I would be minded to allow the appeal in this respect. But it is not the only point.

The second point seems to me to be conclusive. The judge pointed out correctly that on the undisputed facts of this case the receivership and the sale of the property had been effectively completed and arranged before the acquisition of the shares in Oasis at all. One can see that from the chronology. The offer of the Bennetts had been accepted on 13 February, subject to contract and finance. What followed, and the acquisition of Oasis, was to provide the vehicle into which the investment of Tuneclass could be inserted, so that the acquisition with their money might go ahead through the vehicle of Oasis. Oasis had nothing whatever to do with the breaches of duty of which complaint is made, and in so far as it did anything at all, it was the wholly passive recipient. For reasons I have endeavoured to explain in relation to the knowing receipt clause, it is not liable as a constructive trustee under that heading for the receipt of the company's business, and I can see no reason in equity why it should be made liable as a constructive trustee for the business under the knowing assistance limb when, as is admitted, it gave full value for the business of the company as it existed at the time when it acquired it.

It is suggested by Mr Oliver that such a conclusion runs counter to statements or propositions of Peter Gibson J in *Baden v Société Générale pour Favoriser le Développement du Commerce et de l'Industrie en France SA* [1983] BCLC 325, [1993] 1 WLR 509 and by Sir Robert Megarry V-C in *Re Montagu's Settlement Trusts* [1992] 4 All ER 308, [1987] Ch 264 that the remedy of constructive trusteeship is a flexible remedy designed to satisfy the demands of conscience and is not therefore susceptible to greater analysis. I can readily accept that, but if there is no causative effect and therefore no assistance given by the person, namely Oasis, on whom it is sought to establish the liability as a constructive trustee, for my part I cannot see that the requirements of conscience require any remedy at all. I would therefore uphold the judge's judgment on the second reason that he gave, under the claim of knowing assistance.

Mr Oliver, in my view frankly and wisely, accepted that the claim for conspiracy against Oasis stood or fell with the claim against Oasis for knowing assistance. It follows from my conclusion on knowing assistance that I would likewise not accept his submissions in relation to conspiracy.

This leaves the claim against Mr Sarson. That is pleaded in para 83 of the amended statement of claim as follows:

> 'From about November 1990 Mr Sarson assisted the Bennetts to plan the acquisition of the business for themselves by causing the Company to go into receivership and a new company to buy the business back from the receiver with a view to participating (via the new company) in the business himself when so purchased, and between January and March 1991 he assisted the Bennetts in the execution of that plan.

By such action he participated in and/or assisted the Bennetts to commit the breaches of fiduciary duty pleaded in paragraph 53 above knowing that the conduct of the Bennetts therein pleaded was dishonest. a

Reference will be made to paragraphs 78 to 90 of the Particulars to support this allegation.'

When one goes back to para 53, it is said that: b

'From about November 1990 having caused such financial pressure, they [that is to say the directors] planned to acquire the business for themselves by causing the Company to go into receivership and (via a new company) buying the business back from the receiver, and between January and March 1991 they duly executed that plan.' c

In the particulars, paras 78-90, to which the pleading refers, para 78 refers to Mr Sarson being instructed by the Bennetts to prepare a plan for, effectively, a phoenix operation, and it is alleged that he duly prepared such a plan using the company's confidential information. Then further d allegations are made with regard to the plan. In para 80 it is alleged that Mr Sarson, again acting on the instructions of the Bennetts, prepared two more business plans, and then there is reference made to the incorporation of Oasis, the increase of its capital and so forth. Paragraph 85 refers to the advertisement of the business of the company for sale, the change of name by the new company to Oasis and the sale agreement to Oasis made on 7 March e 1991. Paragraph 86 alleges that, amongst others, Mr Sarson was employed by Oasis immediately and became its company secretary. Then in para 89 it is asserted that, amongst others, Mr Sarson knew that the said plan was dishonest because he knew it was dishonest of the Bennetts to retain the head office costs at an insupportable level and to increase the costs and cause the f company to incur the aforesaid capital expenditure.

The judge considered that the allegations which I have sought to summarise did not adequately particularise a cause of action against Mr Sarson, of which dishonesty was a necessary ingredient. That dishonesty was a necessary ingredient for a dishonest assistance claim is apparent from *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, [1995] 3 All ER 97, g to which I have already referred. The judge said ([1998] 2 BCLC 97 at 107):

'This head of claim against Mr Sarson depends on the plaintiffs' pleading and proving dishonesty on his part within the second limb of *Barnes v Addy* (as well, of course, as persuading the court to extend that h limb to a case not involving a breach of trust affecting property). It does not seem to me that the proposed amended statement of claim contains any sufficient particulars of such dishonesty to comply with RSC Ord 18, r 12, and, to judge by the voluntary particulars, no sufficient such particulars would be forthcoming if sought. Accordingly I do not i consider it appropriate to allow those parts of the proposed amended statement of claim which purport to plead a claim against Mr Sarson under the heading of breach of fiduciary duty.'

a Mr and Mrs Brown, through Mr Oliver, contend that the judge was wrong. They submit that para 83 in its original form alleges that Mr Sarson knew that the Bennetts' conduct was dishonest and that that is sufficient. Mr Sarson, of course, disagrees with that, and sought to uphold the judge's decision on the grounds on which it was given. Before us Mr Oliver sought to maintain his appeal against the judge's conclusion. We were concerned that at root this was only a pleading point and, if that was the case, it could be exposed by an opportunity being given to Mr Oliver and Mr Asprey to produce a revised draft so as to put the pleading in a form with which they felt they were happy and which they thought would give rise to sufficient particularity. The consequence was that at two o'clock they returned with a form of addendum to be inserted before the reference being made to paras 78-90 of the particulars in para 83 of the amended statement of claim.

The addendum reads as follows:

> 'Such action [which refers back to the first paragraph, paragraph 83] was in itself dishonest, in that participation in and/or assistance of the commission of breaches of fiduciary duty known to be dishonest is itself dishonest. Mr Sarson was the Company secretary and as such attended meetings of the board of directors and was responsible for production of the management accounts of the Company. He knew that it was dishonest of the Bennetts to retain the head office costs at an insupportable level and to increase the said costs and to incur the aforesaid capital expenditure in that no reasonable person could possibly have agreed to such retention, increase or expenditure, and because all this occurred at a time when the Company was in breach of its banking covenants, it was unclear whether or upon what terms the Midland would be prepared to continue supporting the Company, and when no steps had been taken to secure funds to cover the resulting losses.'

Miss Dohmann contended that, notwithstanding those amendments, the pleading was still defective. She suggested that the particulars had been abandoned in the court below and that there was nothing in the notice of appeal by which they were resuscitated. She pointed out that Mr Sarson was only ever the company secretary and therefore had no executive responsibility for the acts of the Bennetts alleged to have been dishonest. She submitted that planning the phoenix operation was not of itself necessarily dishonest, and she suggested that the claim as made in the addendum was redolent of judicial review rather than claims for fraudulent conduct.

I take the view that Miss Dohmann's objections may be proved right at trial, but that is no objection to the pleading of them at this stage. It seems to me that if, as Mr Oliver did, application is made for leave to amend it should be granted on the usual terms, and that he should be able to maintain that allegation to trial for such success as it may give him. I reach that conclusion not only because technically I think it is an adequate pleading but, secondly, because since the claim for conspiracy is going to trial anyway, there seems to me little point in leaving out this central part of the plaintiff's claim

because of a certain lack of particularity. For all the reasons I have endeavoured to explain, I would grant leave to amend in relation to Mr Sarson, but subject to that I would dismiss the appeal.

a

ALDOUS LJ. I agree.

HUTCHISON LJ. I also agree.

Appeal dismissed.

b

Kenneth Dow Esq Barrister.

Chapter 14 Derivative Claims

[14.1]

CHAPTER 5 to CHAPTER 13 considered duties that are imposed on directors. This chapter begins a series of chapters that are, in a sense, ancillary to those that have gone before. CHAPTER 14 to CHAPTER 17 address matters that are related to consequences that flow from either the existence of the general duties or their breach. This chapter addresses the issue of derivative claims, claims that can be initiated by shareholders on behalf of their company and against directors for breach of their duties[1].

[1] Parts of this chapter draw on elements of: A Keay and J Loughrey 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action Under the Companies Act 2006' (2008) 124 LQR 469; A Keay and J Loughrey 'Derivative Proceedings in a Brave New World for Company Management and Shareholders' [2010] JBL 151; A Keay and J Loughrey 'An Assessment of the Present State of Statutory Derivative Proceedings' in J Loughrey (ed) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar, 2013), Chapter 7; A Keay 'Applications to Continue Derivative Proceedings on Behalf of Companies and the Hypothetical Director Test' (2015) 34 *Civil Justice Quarterly* 346; A Keay 'Assessing and Rethinking the Statutory Scheme for Derivative Actions Under the Companies Act 2006' (2016) 16 *Journal of Corporate Law Studies* 39. The last paper provides a detailed discussion of the possible flaws in the statutory scheme for derivative actions and the case law that has interpreted the scheme as well as possible reform measures that could be implemented to address the flaws.

[14.2]

If directors breach their duties to the company, English law has always held that the company was the correct complainant, and had to commence proceedings against the errant directors. This is known as the rule in *Foss v Harbottle*, deriving from the case of the same name[1]. In the far more recent case of *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)*[2] the Court of Appeal explained the effect of the rule when it stated that A is not able usually to take action against B in order to recover damages or other relief on behalf of C, where B has acted in such a way as to injure C. Sometimes this is known as 'the proper plaintiff rule'[3]. We know from s 170 of the CA 2006 that the general duties of directors are owed to the company, and not to the members, or anyone else, and so if there is any breach by a director it is logical that the company is the one who should take action for relief. The rule in *Foss v Harbottle* is also based on the notion of majority rule, and that the will of the majority is to be identified with the company's[4].

[1] (1843) 2 Hare 461, 67 ER 189.

[2] *[1982] Ch 204* at 210.

[3] For example, see *Edwards v Halliwell [1950] 2 All ER 1064*; *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204* at 210.

[4] *Edwards v Halliwell [1950] 2 All ER 1064*.

[14.3]

The board of directors is usually charged with the management of the company, and the articles will usually invest the directors, as part of broad management powers, with the power to litigate and enforce the company's interests[1]. But they are not always the best people to decide whether one or more of their number

should be sued[2]. Clearly, and not infrequently, boards have refrained from taking action for a number of reasons. One, of course, could be that the whole board or those who control the board are seen as the wrongdoers. Another might be that the board could be concerned that action against one or two directors could affect the whole board. Thirdly, the board might be worried that any judgment obtained might not be able to be satisfied, and, therefore, costs expended in litigation might not be recovered. A fourth reason is that the board might refrain from taking any action against one or more of its number as the non-erring directors might feel that if they are tolerant of the miscreants those miscreants might show reciprocal tolerance if they commit any wrongdoing in the future. Fifthly, and allied to the latter reason, is that boards are groups and are clearly affected by group dynamics. They have been described as 'elite and episodic decision-making groups'[3], and there seems little doubt that boards are heavily dependent on social-psychological processes and they will be affected by social-psychological factors[4]. Therefore, directors may decide not to take action because they are influenced by: the fact that they have become friendly with the miscreant; other members of the board, and especially senior executives like the CEO[5], might support the miscreant; issues of collegiality which might mean that directors find it difficult to question actions of colleagues[6]. Sixthly, there is the cost of legal proceedings. Like any prospective litigant the company has to consider the likely costs that will be incurred. If the company were to take action and lose, then it is probable that costs would be awarded against it. Even if it were to succeed it might not be able to reclaim all of its costs from the other party. Seventhly, again like anyone considering taking legal action, the board has to be convinced that the company would have a good chance of succeeding. The shareholders are not going to thank the board for spending money in taking action that was not supported by cogent evidence and advice from lawyers that suggests a good chance of success. Eighthly, the board might be embarrassed by the breach. Board members might feel that they were, or could be perceived as, 'asleep on the job', or that they put too much faith in the director, and this will affect their reputation. Finally, the board might take the view that it is better for business that the breach is not publicised on the basis that it might bring either or both of the board and the company into disrepute[7]. Liquidators have always been able to take action against errant directors, but it would be highly unfortunate if actions could not be brought until a company enters liquidation (or administration). There has to be some process that allows actions to be brought if the directors themselves refrain from taking action. At common law the courts developed some exceptions to the rule that no action could be brought to enforce a liability owed to the company, save by the company, in order to permit shareholders to commence proceedings. These proceedings came to be known as derivative proceedings, the description being used first in the UK by the Court of Appeal in *Wallersteiner v Moir (No 2)*[8]. The reason for the use of the description is that the right to bring the proceedings was derived from the right of the company.

[1] For example, the Companies (Tables A–F) Regulations 1985, Table A, reg 70. The Companies (Model Articles) Regulations 2008, SI 2008/3229, reg 2, Sch 1, art 5 (private companies); reg 4, Sch 3, art 5 (public companies).

[2] See R Nolan 'The Legal Control of Directors' Conflicts of Interest in the United Kingdom: Non-Executive Directors Following the Higgs Report' (2005) 6 *Theoretical Inquiries in Law* 413 at 424.

[3] D Forbes and F Milliken 'Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-making Groups' (1999) 24 *Academy of Management Review* 489 at 492.

[4] D Forbes and F Milliken 'Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-making Groups' (1999) 24 *Academy of Management Review* 489 at 493.

[5] See, M O'Connor 'The Enron Board: The Perils of Groupthink' (2003) 71 *University of Cincinnati Law Review* 1233.

[6] J Macey *Corporate Governance: Promises Kept, Promises Broken* (Princeton University Press, Princeton, 2008) at 61.

[7] A Keay 'An Assessment of Private Enforcement Actions for Directors' Breaches of Duty' (2014) 33 *Civil Justice Quarterly* 76.

[8] *[1975] QB 373*. The description was borrowed from American law.

[14.4]

There are objections to the concept of a derivative action. First, the action taken is not authorised by the appropriate company organ[1]. Secondly, the applicant is endeavouring to circumvent the majority rule principle[2]. Nevertheless, UK law has seen fit, first through the courts, and now through legislation, to permit such actions in limited situations.

1 R Hollington *Shareholders' Rights* (London, Sweet and Maxwell, 5th edn, 2007) at 131.

2 R Hollington *Shareholders' Rights* (London, Sweet and Maxwell, 5th edn, 2007) at 132.

[14.5]

The right to initiate derivative proceedings has been seen as a part of the arsenal of weapons that members have to control the directors. Some might say, with justification, that this arsenal is not that substantial or powerful[1]. The member brings a derivative claim on behalf of all the members who are not made defendants[2]. Perhaps to make the weapon a little more powerful the CA 2006, following significant examination and debate, has done what several Commonwealth jurisdictions[3] have done, provides a statutory derivative action procedure. The scheme was put in force on 1 October 2007[4].

1 See A Keay 'Company Directors Behaving Poorly: Disciplinary Options for Shareholders' [2007] JBL 656.

2 *Cooke v Cooke [1997] 2 BCLC 28* at 31.

3 For example, see Pt 2F1A of the Corporations Act 2001 (Australia); Canada Business Corporations Act 1985, s 239 (Canada); Companies Act 1990, ss 216A and 216B (Singapore). Also, note that Hong Kong as introduced a legislative scheme. See Companies Ordinance, ss 2 and 168BC–168BG (HK). It became operative from 15 July 2005.

4 Companies Act 2006 (Commencement No 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007, SI 2007/2194, art 2(1)(e).

[14.6]

The focus of the book is on directors' duties, but it would be remiss of the book if it did not address the issue of derivative claims in some depth as it has potentially great relevance to the enforcement of breaches against miscreant directors where the board fails to take action. However, the discussion must be limited in length and for further discussion readers might look to more detailed studies of the derivative action process that are provided elsewhere[1].

1 For that, see, for example, A Reisberg *Derivative Actions and Corporate Governance* (OUP, 2007) generally; R Hollington *Shareholders' Rights* (London, Sweet and Maxwell, 6th edn, 2012) ch 6; V Joffe et al *Minority Shareholders: Law, Practice and Procedure* (OUP, 4th edn, 2008) ch 3.

[14.7]

How important the procedure is, is a matter of some debate. It has been asserted that we live in a world where shareholder activism is becoming more widespread[1], so this might mean a greater use of derivative actions. But Lord Goldsmith said, when taking part in the debates in the House of Lords on the Company Law Reform Bill 2005, that: '[On] the provision of new duties, we do not see why that should lead to increased litigation either'[2]. In fact there does not appear to have been an increase in litigation at all, when compared with the level of claims before the Companies Act 2006 was enacted. In fact, as indicated shortly, there has been a relative paucity of cases brought before the courts. Notwithstanding that, clearly the action has potential importance and plays a critical role in the area covered by the book.

1 G Milner-Moore and R Lewis *In the Line of Fire – Directors' Duties under the Companies Act 2006*.

2 Lords Grand Committee, 6 February 2006, col 2.

[14.8]

Before examining the provisions that allow for shareholders to initiate derivative claims, the chapter discusses, somewhat briefly, the position at common law so as to provide some background to the statutory action. The chapter also considers in some detail the criteria that any shareholder who wishes to bring a derivative claim has to satisfy and the likely effect of the statutory scheme on litigation, as well as the position where causes of action occurred before the date on which the new scheme was put in force. The chapter examines whether a derivative action is possible where a company is in liquidation or is insolvent and whether a multiple-derivative claim is possible under UK law. While the new statutory derivative claim has been in effect for 13 years we still do have, as indicated above, a relatively low corpus of case law that addresses the new scheme. Since the scheme was put into law until 1 April 2016, 24 derivative claims were instituted[1], working out to be an average of 2.82 cases per year, which is actually less than that found in a study conducted in 2010[2]. The possible reasons for the paucity of cases has been the subject of a paper in 2016[3]. Since 2016 there has not been a great increase in claims so that the corpus of claims is still not large. So, we can say that the number of occasions on which a shareholder has succeeded in obtaining permission to continue a claim has always been low since 2007 and continues to be so.

1 A Keay 'Assessing and Rethinking the Statutory Scheme for Derivative Actions Under the Companies Act 2006' (2016) 16 *Journal of Corporate Law Studies* 39. All of the cases dealt with permission hearings. This was from a search of Westlaw, Lawtel and Lexis databases. Cases, such as multiple-derivative actions, based on the common law procedure were not included. A 'multiple-derivative' action is a derivative action that is entitled to be brought by minority shareholders of a parent company for a breach of duty owed to a direct or indirect subsidiary, certainly where control of the subsidiary is not independent of the parent company's board. These applications are not brought under the statutory scheme but under the common law. See, *Re Fort Gilkicker Ltd [2013] EWHC 348 (Ch), [2013] BCC 365*. These kinds of proceedings are discussed later in the chapter.

2 A Keay and J Loughrey 'Derivative Proceedings in a Brave New World for Company Management and Shareholders' [2010] JBL 151. This study found the number of cases per annum was 3.2.

3 A Keay 'Assessing and Rethinking the Statutory Scheme for Derivative Actions Under the Companies Act 2006' (2016) 16 *Journal of Corporate Law Studies* 39.

[14.9]

The chapter draws principles and insights not only from these cases, but also from the cases which dealt with the common law procedure (while the common law process has been abolished by the CA 2006 as far as ordinary derivative claims are concerned[1] the principles in the case law can be informative) and the jurisprudence from Commonwealth jurisdictions which have previously embraced a statutory derivative action scheme, and particularly Australia whose legislation is, perhaps, the closest of all Commonwealth countries to that of the UK's.

1 *Re Fort Gilkicker Ltd [2013] EWHC 348 (Ch), [2013] BCC 365*.

I THE COMMON LAW: SOME BACKGROUND

[14.10]

It is helpful to rehearse, briefly, the position at common law by way of background to the discussion of the statutory regime that now applies, and to enable us to have some context for the consideration of the cases

which dealt with the common law position. These cases may well be relevant, to some extent, to the deliberations of courts hearing applications under the statutory procedure. Also, it would seem that where there is a cause of action that could be the subject of a derivative claim, and it occurred before 1 October 2007, shareholders can only obtain permission to bring proceedings if they meet the requirements at common law[1]. It is unlikely that any action would be brought in relation to the period before codification because of limitation of action issues. It is important to note at this point that, as discussed later in the chapter, multiple-derivative actions will be subject to the common law as they do not come within the statutory scheme.

1 Companies Act 2006 (Commencement No 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007, SI 2007/2194, art 20(2).

[14.11]

The derivative action developed at common law in order to provide a remedy for a company where the company had suffered a wrong but the wrongdoers were in control of the company, and they prevented it from taking legal proceedings in relation to that wrong. In such circumstances, and as already foreshadowed, the courts permitted individual shareholders to bring an action on the company's behalf, with the cause of action being derived from that belonging to the company. The court's decision constituted an exception to the rule that, where a wrong is done to the company, the company, as a separate legal entity, is the proper claimant in respect of that wrong. The decision of the courts to allow this exception was to do justice to the company, and they had a wide discretion in whether they considered that the exception should or should not be applied.

[14.12]

Notwithstanding the courts' decision to permit derivative proceedings, they were mindful of vexatious and disruptive litigation that could be taken by minority shareholders. Consequently, even if the company had a good claim against the alleged wrongdoers, an action brought on the company's behalf by a minority shareholder would not succeed unless the shareholder could establish standing to sue on the company's behalf. The rules on standing were restrictive. It was necessary for shareholders to bring themselves within the exception to rule in the case of *Foss v Harbottle*[1], and demonstrate that there was a prima facie case on the merits that there had been a 'fraud on the minority', which could not be ratified by the shareholders in general meeting[2], and also that the company was under the control of the wrongdoer(s)[3]. Usually a fraud on the minority would involve an abuse of power by directors in a fraudulent or negligent manner and so as to benefit them and hurt the company. Wrongdoer control might be constituted by the prevention of the bringing of a claim by the company. Wrongdoer control will exist if the persons who have acted wrongly have control of the majority of votes at a general meeting of the company, or the majority has approved a fraud on the minority, or the majority stifles legal action against the wrongdoer(s). If the wrongdoers were not in control of the company then the law's attitude was that the whole matter should be left to the company[4]. But the law never demanded, before accepting that wrongdoer control exists, that a company meeting had been called and refused to institute proceedings against the wrongdoers. Wrongdoer control has been able to be demonstrated in other ways[5]. While the court in *Pavlides v Jensen*[6] seemed to regard wrongdoer control as being based on the majority being able to exercise their votes in order to have a decision in their favour, the Court of Appeal in *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)*[7] preferred a wider approach to control. The court said that control could mean, at one extreme the wrongdoers could cast the majority of votes, and at the other extreme it could mean the situation where the majority of votes were in fact constituted by the wrongdoers together with those votes of people who were apathetic and/or those influenced by the wrongdoers[8].

1 *(1843) 2 Hare 461*, *67 ER 189*.

2 See Chapter 15, which deals with ratification.

3 *Prudential Assurance Co Ltd v Newman Industries Ltd [1982] Ch 204* at 221–222. There have been statements to the effect that there were a number of exceptions to the rule (see *Edwards v Halliwell [1950] 2 All ER 1064*).

4 *Edwards v Halliwell [1950] 2 All ER 1064* at 1067.

5 *Mason v Harris (1879) LR 11 Ch D 97* at 108 (CA); *Alexander v Automatic Telephone Co [1900] Ch 56* at 69 (CA).

6 *[1956] Ch 565.*

7 *[1982] Ch 204.*

8 [1982] Ch 204 at 219.

[14.13]

Perhaps a classic case that illustrates wrongdoer control, and which has been referred to in earlier chapters, was *Cook v Deeks*[1]. Here three directors of a four-director company, X, negotiated on behalf of X to secure some contracts for the construction of a railway. During the course of their negotiations, the directors arranged for the contracts to be performed by them rather than X. The directors formed a new company especially to carry out the contracts. The fourth director of X learned of this, but the other three controlled the company and refrained from taking action against themselves on behalf of X. The fourth director brought derivative proceedings, successfully, as a minority shareholder to enforce the rights of X.

1 *[1916] AC 554.*

[14.14]

As a minority shareholder's ability to bring a derivative action was regarded by the courts 'as a matter of grace'[1], even if shareholders managed to satisfy the requirements concerning wrongdoer control, they would still be refused permission if the court took the view that permission should not be granted to the relevant shareholder because of attributes which were personal to him or her[2]. Courts would not permit the shareholder to pursue the action if it was not being brought bona fide, the member did not have a proper purpose, or there was another remedy available to the member[3]. Also, pursuant to something of a controversial development, in *Smith v Croft (No 2)*[4], Knox J held that where an independent majority of the minority shareholders did not wish a derivative action to proceed, the action would not be permitted[5].

1 *Mumbray v Lapper [2005] EWHC 1152 (Ch), [2005] BCC 990* at [121], citing L C B Gower *Modern Company Law* (London, Sweet and Maxwell, 4th edn, 1979) at 652.

2 J Payne '"Clean Hands" in Derivative Actions' (2002) 61 CLJ 76 at 81.

3 *Barrett v Duckett [1995] BCC 362.*

4 *[1988] Ch 114* at 159.

5 *Smith v Croft (No 2) [1988] Ch 114* at 184–185. Professor Paul Davies was of the view that this decision would have a destructive effect if followed in other courts: P Davies *Gower and Davies' Principles of Company Law* (London, Sweet and Maxwell, 7th edn, 2003) at 463.

[14.15]

The question of the shareholder's standing to sue in a derivative action was not dealt with in the substantive proceedings until the decision in *Prudential Assurance Co Ltd v Newman Industries Ltd*[1], where it was established that the standing issue had to be settled as a preliminary matter[2]. Then, in 1994, the rules of court were amended to require shareholders to seek leave of the court to pursue a derivative action[3], and it was the duty of the court to ascertain, as a preliminary issue, whether the shareholder should be allowed to sue derivatively[4]. At common law leave had to be applied for early on, after the plaintiff had issued the claim form and before taking any other step in the proceedings[5] The time limit within which the application had to be issued was within the time period for service of the claim form, being within four months of issue of the claim form for service within the jurisdiction and six months outside[6]. The courts said that it was critical that they maintained control, and the seeking of permission was not simply a technicality[7].

1 *Prudential Assurance Co Ltd v Newman Industries Ltd [1982] Ch 204*.

2 *Prudential Assurance Co Ltd v Newman Industries Ltd [1982] Ch 204* at 221.

3 RSC Ord 15 r 12A.

4 *Barrett v Duckett [1995] 1 BCLC 243* at 250.

5 RSC Ord 15, r 12A which required that the application had to be made within 21 days of intention to defend being given. This was superseded by CPR 19.9(3). The common law procedure is discussed in R Reed 'Derivative Claims: The Application for Permission to Continue' (2000) 21 Co Law 156.

6 CPR 19.9(5); CPR 7.5.

7 *Portfolios of Distinction Ltd v Laird [2004] EWHC 2071 (Ch), [2005] BCC 216* at [60].

[14.16]

Professor Paul Davies was of the opinion in 2003 that the balance at common law between the concept of a desire to see the collective nature of decision-making fostered, on the one hand, and the need for the enforcement of directors' duties, on the other, had been upset to the point that the former was advantaged over the latter, and so reform was warranted in a new Companies Act[1]. It is submitted that, as manifested by the discussion in the balance of the chapter, the statutory procedure has not changed things as far as greater enforcement of directors' duties by is concerned.

1 P Davies *Gower and Davies' Principles of Company Law* (London, Sweet and Maxwell, 7th edn, 2003) at 463.

Directors' Duties/Chapter 14 Derivative Claims/II The statutory derivative claim/A The elements for gaining permission

II THE STATUTORY DERIVATIVE CLAIM

[14.17]

The statutory derivative claim, which came into operation on 1 October 2007, completely replaces the common law[1]. According to Lord Goldsmith, speaking for the Government in the debates in the House of Lords, the statutory process would provide greater clarity as to how a member might bring a derivative claim[2]. The scheme does not include the concepts of fraud on the minority or wrongdoer control[3], concepts that dominated derivative actions at common law. It should be mentioned at this point that while the scheme might be

said to have replaced the common law as far as the archetypal derivative claim is concerned, it does not apply to multiple-derivative actions. This is, as mentioned above, discussed later in the chapter. The scheme does apply to charitable companies as well as commercial ones, but the Court of Appeal has said that it was unable to envisage the situation in which a court would give permission to continue a derivative claim on behalf of a charity[4].

[1] This is the same as in Australia, Canada and New Zealand, but compare the situation in Hong Kong where the two schemes sit side-by-side: *Waddington Ltd v Chan Chun Hoo Thomas [2008] HKCFA 63*, *(2008) 11 HKCFAR 370*, *[2009] 4 HKC 381*, *[2009] 2 BCLC 82*. Ribeiro PJ (at [29]–[32]) criticised this state of affairs.

[2] Lords Grand Committee, 27 February 2006, Hansard HL 679, col GC 4–5.

[3] Although some cases suggest that this might be of relevance. For example, see *Stimpson v Southern Landlords Association [2009] EWHC 2072*, *[2010] BCC 387* at [46], *[2011] EWHC 3146 (Ch)*, *[2012] BCC 700* at [81]; *Bridge v Harvey [2015] EWHC 2121* (Ch) at [25]. See the discussion below at 14.112.

[4] *Mohamed v Abdelmamoud [2018] EWCA Civ 879*.

[14.18]

We do have case law on the procedure involved in obtaining permission to continue a derivative claim, but, as mentioned earlier, not a great deal. So, as mentioned earlier, this chapter relies for some assistance on the case law prior to the statutory regime coming into force and Commonwealth case law, and particularly the Australian regime.

[14.19]

There are two rationales that are often given for the existence of statutory derivative proceedings[1]: first, to ensure, if possible, that the company is compensated for the wrongdoing of its directors; secondly, it deters directors from acting improperly. Pearlie Koh has said[2] that:

> "The introduction of the statutory derivative action is often premised on the view that an enhanced shareholder role not only complements existing regulatory regimes, and in the case of publicly held corporations, market and social forces, by deterring managerial wrongdoing, but is also effective in raising management's obligations and duties beyond a merely hortative level."

[1] See S Bottomley *The Constitutional Corporation* (Aldershot, Ashgate, 2007) at 157.

[2] P Koh 'Directors' Fiduciary Duties: Unthreading the Joints of Shareholder Ratification' (2005) 5 JCLS 363 at 376.

[14.20]

Under the CA 2006, as was the case at common law, permission has to be applied for by a member early on, just after the commencement of the derivative claim. The procedure for permission that is set down in the CA 2006 is critical to the statutory scheme's operation.

[14.21]

We have already noted that at common law, following the decision in *Prudential Assurance Co Ltd v Newman Industries Ltd*[1], standing had to be dealt with as a preliminary matter and since 1994 the rules of court

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have been amended to require shareholders to seek leave of the court to pursue a derivative claim. Consequently, the requirement in s 261(1) of the CA 2006 for permission to continue a claim is not altogether new.

1 *Prudential Assurance Co Ltd v Newman Industries Ltd [1982] Ch 204*.

[14.22]

As mentioned above, an application may be brought only by a member[1], and includes a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law[2]. It does not matter if the cause of action that is the subject of the claim occurred before he or she became a member[3]. In some other jurisdictions a former member may bring proceedings[4].

1 Section 260(1).

2 Section 260(5).

3 Section 260(4).

4 For example, under the Australian Corporations Act 2001, s 236(1)(a)(i). In Canada applications by such persons have been denied on the basis that they did not have a sufficient interest. See, for instance, *Jacobs Farms Ltd v Jacobs (1992) OJ No 813* (Ont Gen Div).

[14.23]

While derivative claims are regularly and rightly associated with claims by minority shareholders, the legislation does not appear to exclude majority shareholders from bringing a claim. Practically it is not likely that a majority shareholder would want to, or, at least, to do so in only the most exceptional circumstances. This is reflected in *Cinematic Finance Ltd v Ryder*[1] where Roth J said that he would not say that it was never appropriate for a majority shareholder to be granted permission to bring a derivative claim, but it would only be in exceptional circumstances and he had difficulty in envisaging such exceptional circumstances[2]. In this case the majority shareholder/claimant could not establish exceptional circumstances.

1 *[2010] EWHC 3387 (Ch)*, *[2012] BCC 797* at [22].

2 *[2010] EWHC 3387 (Ch)*, *[2012] BCC 797* at [14].

A The elements for gaining permission

[14.24]

The elements for gaining permission are set out in ss 261 and 263 of the CA 2006 for England and Wales and Northern Ireland and ss 266 and 268 for Scotland, with the other sections of the relevant chapter of Pt 11 (Chapter 1 for England and Wales and Northern Ireland and Chapter 2 for Scotland) setting out the procedure for bringing the claim and what must be established for success[1]. The following will deal with the provisions that apply in England and Wales and Northern Ireland but the Scottish provisions are very similar. In Scotland the claimant has to seek leave from the court to initiate derivative proceedings[2]. In Northern Ireland a shareholder does not seek permission but leave.

1 For discussion of practical and procedural issues, see V Joffe et al *Minority Shareholders: Law, Practice and Procedure* (Oxford, OUP, 2008) ch 1.

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[2] For instances of decisions dealing with the Scottish provisions, see, *ICU (Europe) Ltd v Ibrahim* [2016] CSIH 62; *Witter v QHSE Solutions Ltd* [2016] SAC (Civ) 8.

[14.25]

According to the statutory scheme, a derivative claim is one that is initiated by a member of the company in relation to a cause of action that is vested in the company, and relief is sought on behalf of the company[1].

[1] CA 2006, s 260(1).

[14.26]

A claim may be brought where there is a cause of action arising from an actual or proposed action or omission involving negligence, default, breach of duty or breach of trust by a director of the company[1]. Clearly a derivative claim can be initiated where a director is in breach of the general duties, which are the subject of this work. As mentioned above, it does not matter if the cause of action arose before or after the applicant/claimant became a member of the company[2]; this preserves the common law position. The fact that the member may bring a claim in relation to happenings prior to his or her becoming a member makes sense as the claim relates to a wrong done to the company and not to the member. Effectively applicants are limited to members. This is the position with most jurisdictions around the world, but a number of other jurisdictions do allow for a wider range of applicants. For instance, s 238 of the Canada Business Corporations Act 1985 includes members, certain creditors, and directors, and also applications may be made by 'any other person who, in the discretion of a court, is a proper person to make an application'. Similarly, s 216A(1)(c) of the Singaporean Companies Act provides that the range of persons who can apply to bring a derivative claim includes 'any other person who, in the discretion of the court, is a proper person'.

[1] CA 2006, s 260(3).

[2] CA 2006, s 260(4).

[14.27]

Applicants now are able to instigate derivative claims in a broader range of circumstances than at common law, although the range is not sufficiently wide enough to cover any action against anyone under any cause of action that the company has, and where no action has been instigated by the board. Under the present scheme, the action must be one that arose as a result of the actions of the directors[1].

[1] Section 260(3) of the Act. See *Iesini v Westrip Holdings Ltd* [2009] EWHC 2526 (Ch), *[2010] BCC 420*, [75].

[14.28]

For the purposes of Chapter 1 of Pt 11, 'director' includes a former director, and a shadow director is treated as a director[1]. What about de facto directors? The fact that there is no legislative provision that defines the term might mean that there is no need to refer to the term. As a de facto director owes the same duties owed by a *de jure* director[2], a member might be able to bring a claim against a de facto director if he or she is in breach of a duty. In any event, s 260(3) of the CA 2006 does state that an action may be brought against a director or *another person*, and this might be said to cover de facto directors. It is likely that the inclusion of the words 'another person' is essentially to cover cases where someone, not a director, has aided the director in the breach or received property as a result of the breach when knowing the director has committed a breach[3]. In the latter situation it would be critical for an order to be sought that property passed to a third party by a miscreant director could be recovered for the company[4]. Another case where action might be

taken against a third party could be where a third party has been negligent and the company has a cause of action against that party, but the directors decided that they will not proceed against the third party. Perhaps the directors might be concerned that the third party will seek contribution from the directors on the basis that they were guilty of contributory negligence, which is what occurred in *AWA Ltd v Daniels*[5] when the company sued the company's auditors and the auditors joined the directors by way of third party notice (contribution notice) on the basis that they were liable because of contributory negligence. It might be argued that if directors declined to bring proceedings against someone who had wronged the company the directors themselves would be in breach of one or more of their duties.

[1] CA 2006, s 260(5)(a), (b).

[2] *Re Canadian Land Reclaiming and Colonizing Co (1880) 14 Ch D 660* at 670 (CA); *Mistmorn Pty Ltd (in liq) v Yasseen (1996) 21 ACSR 173*, (1996) 14 ACLC 1387; *Ultraframe UK Ltd v Fielding [2004] RPC 24* at [39]; *Ultraframe UK Ltd v Fielding [2005] EWHC 1638 (Ch), [2006] FSR 17* at [1257]; *Primlake Ltd v Matthews Associates [2006] EWHC 1227 (Ch), [2007] 1 BCLC 686* at [284].

[3] Lord Goldsmith in the House of Lords made it clear that it was envisaged that there would only be a right against a third party where there had been a breach of duty by a director: Lord Goldsmith, Lords Grand Committee, 27 February 2006, Hansard HL, vol 679, col GC10.

[4] The substance of this is discussed in CHAPTER 15.

[5] *(1992) 10 ACLC 933*.

[14.29]

Remedies for a successful derivative claim will be the same as they would for a claim brought by the company.

Directors' Duties/Chapter 14 Derivative Claims/II The statutory derivative claim/B The practice and procedure

B The practice and procedure

[14.30]

In England and Wales it is important to note that a derivative action is commenced[1] and then the claimant/member must obtain the permission[2] of the courts to continue it[3]. Rule 19.9(4) of the Civil Procedure Rules 1998 ('CPR') indicates that once a derivative proceeding has been commenced (and this is done by claim form) the claimant must not take any further action without obtaining the formal permission of the court[4]. In some other jurisdictions around the world an application has to be made to the court for permission to commence an action[5].

[1] This section of the chapter draws on A Keay and J Loughrey 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action Under the Companies Act 2006' (2008) 124 LQR 469.

[2] In Northern Ireland a shareholder must seek leave to continue the claim: s 261(1).

[3] Section 261(1). In Scotland the procedure is for permission to be sought to enable a claimant to commence derivative proceedings.

[4] Steps permitted by r 19.9A or r 19.9C are exceptions as is an urgent application for interim relief: r 19.9(4)(a)(b).

5 The case in Scotland: s 266(1).

[14.31]

The application for permission must be constituted by an application notice under Pt 23 of the CPR and it must be accompanied by written evidence to support it[1]. The company must not be made a respondent[2].

1 CPR 19.9A(2).

2 CPR 19.9A(3).

[14.32]

Besides the provisions in the CA 2006, rr 19.9–19.9F of the CPR are very important from a practice point of view, and will be mentioned in various places in the chapter. Also, it should be noted that a new Practice Direction was published in relation to derivative claims and in order to supplement rr 19.9–19.9F[1].

1 *Practice Direction 19C – Derivative Claims*. For a discussion of the procedure and practice, see D Lightman 'The Role of the Company at the Permission Stage in the Statutory Derivative Claim' (2011) 30 CLQ 23.

[14.33]

The legislation provides in s 260 for a two-part process for obtaining permission[1]. The courts first have to determine, under s 261, if the claim discloses a prima facie case[2]. If the court comes to the conclusion that no prima facie case is established then the claim is dismissed. But if a case is made out, then the court may direct what evidence is to be provided by the company[3].

1 Explanatory Notes to the CA 2006 at para 492.

2 CA 2006, s 261(2).

3 CA 2006, s 261(3)(a).

[14.34]

If litigation steps are taken in relation to a derivative claim where no permission to continue has been obtained, a court may validate these steps retrospectively as being consistent with both the fact that the court maintains control over the derivative claim procedure and the filtering role which the court undertakes[1]. Validation can occur in relation to steps other than just the service of the claim form, and those subsequent to service[2].

1 *Wilton UK Ltd v Shuttleworth* *[2017] EWHC 2195 (Ch)* at [62], [64].

2 *Wilton UK Ltd v Shuttleworth* *[2018] EWHC 911 (Ch)* at [128].

[14.35]

Besides seeking permission to continue a derivative claim, a member is entitled, under s 262, to apply for permission to continue a company's existing claim as a derivative claim. This is where a company has

brought a claim and the cause of action on which the claim is based could be prosecuted as a derivative claim. Section 262(2) provides that a member may apply for permission in this context on the ground that the way in which the company commenced or continued the claim constitutes an abuse of process of the court, the company has failed to pursue the claim diligently, and it is appropriate for the member to continue the claim as a derivative claim. What does pursuing a claim diligently involve? Probably that the company was taking action in a reasonable way, so if the company merely issued initiating process and did not file pleadings it might be said that it was not pursuing the claim diligently[1]. The type of case envisaged by the legislation is probably where the company has initiated proceedings against directors but has not proceeded with them or is going very slowly. As with applications under s 261, if the court comes to the conclusion that no prima facie case is established then the claim must be dismissed[2], but if a case is made out, then the court may direct what evidence is to be provided by the company[3]. A member may also seek permission, under s 264, to continue an existing derivative claim. The two cases that the provision might be aimed at preventing is, first, where the directors have a member who is friendly to them in order to obtain permission to take derivative proceedings and, once gaining permission, does not prosecute them[4]; and, secondly, where a member obtains permission but is dilatory in taking the matter further. Section 264 applies in circumstances where a derivative claim has been brought, a member has continued as a derivative claim a claim brought by the company or has continued a derivative claim under s 264. In one of these cases another member is entitled to go to the court and seek permission to continue the claim because the manner in which the proceedings were commenced or continued by the claimant constitutes an abuse of the process of the court, the claimant has failed to pursue the claim diligently, and it is appropriate for the member to continue the claim as a derivative claim[5]. Again, as with applications under s 261, if the court comes to the conclusion that no prima facie case is established then the claim must be dismissed[6], but if a case is made out, then the court may direct what evidence is to be provided by the company[7].

1 A Reisberg *Derivative Actions and Corporate Governance* (OUP, 2007) at 144.

2 CA 2006, s 262(3)(a).

3 CA 2006, s 262(4)(b).

4 P Davies *Gower and Davies' Principles of Company Law* (London, Sweet and Maxwell, 8th edn, 2008) at 621.

5 CA 2006, s 264(2).

6 CA 2006, s 264(3)(a).

7 CA 2006, s 264(4)(a).

[14.36]

It would seem that the courts are not overly strict when considering permission applications at the first stage. It has been asserted that there might be the danger of the courts letting the claim pass through the first stage, unless it is clearly a nonsense claim, because there might be something in the claim, possibly as a result of the uncertainty with directors' duties[1].

1 S James 'The Curse of Uncertain Times' (2007) 7 JIBFL 447.

[14.37]

Whether or not such a direction is given under either s 261 or 262 of the CA 2006, s 263(2) provides for a second stage to the permission application. It has two parts to it. First it requires a court, once it has determined that there is a prima facie case for permission, to refuse permission if it is satisfied that a person under

a duty to promote the success of the company would not continue the action, or if the act forming the basis of the claim has been authorised[1] or ratified by the company[2]. If none of these apply then the court moves to the next step, the second part of the second stage, which involves the court considering a number of other elements. At this point the court has a discretion as to whether to allow the claim to proceed. The factors that are enumerated in s 263(3)–(4) will be taken into account by a court in exercising its discretion. They are: whether the shareholder is acting in good faith; the importance which a person operating under a duty to promote the success of the company would attach to continuing the action; whether the act could be ratified[3] or authorised; whether the company has decided not to bring a claim; the availability of an alternative remedy for the shareholder, which he or she can pursue in his or her own right; and the views of the independent members of the company in relation to the action. Independent members would be those with no personal interest in the matter that is the subject of a claim. While a court is required to consider these criteria when determining whether to grant permission, they are not exhaustive and, it would appear, the courts can take account of other relevant factors[4].

1 This probably refers to the authorisation that the board can give under s 175(5). See CHAPTER 9 and CHAPTER 10 for consideration of this latter authorisation.

2 CA 2006, s 263(2). Not all breaches are necessarily ratifiable. See CHAPTER 16. At common law a company could always ratify an action before judgment and, if it did so, it would make a derivative action nugatory. Would the same be possible under the statutory scheme? There is nothing to suggest that the answer is other than in the positive.

3 If an action was ratified then there is not a cause of action which a member could enforce.

4 This follows from the wording of s 263(3) which states that the court must 'in particular' have regard to the listed factors. See also the Law Commission *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at para. 6.73.

[14.38]

In some respects the statutory criteria for the grant of permission have parallels in the common law. This is especially the case with the requirement in s 261(2) that: an applicant must, at the first stage of the process to gain permission, establish a prima facie case; the requirement at the second part of the second stage that the court must consider the applicant's good faith and consideration has to be given as to whether an alternative remedy is available to the applicant[1]. Also, while the common law had no equivalent to s 263(2)(a) or s 263(3)(b), which require courts to consider whether a person acting in accordance with s 172 (the duty to promote the success of the company) would continue with the claim, and the importance such a person would attach to it, it is notable that in a couple of decisions, delivered before the statutory scheme came into operation, the test for the grant of leave at common law has been seen as whether an independent board would sanction proceedings[2]. It has been asserted that it is at least arguable that there is sufficient similarity between these tests that the case law on the latter test could potentially be used in interpreting the former[3], although as the jurisprudence develops on the statutory scheme this may become less and less necessary.

1 CA 2006, s 263(3)(a) and (f).

2 *Mumbray v Lapper* [2005] EWHC 1152 (Ch), *[2005] BCC 990*; *Airey v Cordell* [2006] EWHC 2728 (Ch), *[2007] Bus L R 391* at [56].

3 A Keay and J Loughrey 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action Under the Companies Act 2006' (2008) 124 LQR 469 at 478.

[14.39]

A court will not make an order in relation to any part of a claimant's action that involves him or her making a personal claim. For instance, in *Hughes v Weiss*[1] the claimant included in the general claim, a small claim

that was to be said to be owed by the company to the claimant. The judge refused to deal with it because it was a claim personal to the claimant and not brought on behalf of the company[2].

[1] *[2012] EWHC 2363 (Ch)*.

[2] *[2012] EWHC 2363 (Ch)* at [72]–[74].

[14.40]

The court has the power at a permission hearing to order the company to indemnify the successful shareholder in relation to his or her costs[1]. But, notwithstanding the fact that the Law Commission said that the inclusion of the power to provide for an indemnity was a significant incentive to shareholders to initiate proceedings[2], in reality there is little incentive for shareholders because any relief that is ultimately ordered by a court will go wholly to the company itself[3]. The best that shareholders can hope for is that their costs will be covered, an issue that will be dealt with in detail later.

[1] CPR 19.9E.

[2] *Shareholder Remedies*, Consultation Paper No 142, 1996, para 18.1.

[3] For instance, see I Ramsay 'Corporate Governance, Shareholder Litigation and the Prospects for a Statutory Derivative Action' (1992) 15 *University of New South Wales Law Journal* 149, 150 and 164.

[14.41]

A court might take the view that permission should only be granted up to a particular point in the litigation, such as up until the time of disclosure. This occurred in *Kiani v Cooper*[1], *McAskill v Fulton*[2], and *Wilton UK Ltd v Shuttleworth*[3]. It was also something favoured by Roth J in *Stainer v Lee*[4] where a company had what appeared to be a very strong case of breach of duty, but it was unclear whether all the resulting loss had been repaid.

[1] *[2010] EWHC 577 (Ch)*, *[2010] BCC 463* at [14].

[2] *2014 WL 8106597*.

[3] *[2018] EWHC 911 (Ch)* at [165].

[4] *[2010] EWHC1539 (Ch)*, *[2011] BCC 134* at [37], [55].

[14.42]

The final thing to note is that if defendants to a derivative claim believe that the claimant does not have the authority or standing to bring the claim then they should challenge that at an early stage in proceedings and not postpone it until the filing of their defence in the action[1]. In the case of a claim being instituted by a claimant who lacks authority, and the court is not able to grant authority in the proceedings, a court might allow an adjournment so as to enable the issue to be taken further and, if appropriate, resolved[2].

[1] *Wilton UK Ltd v Shuttleworth* *[2018] EWHC 911 (Ch)* at [129].

[2] *Wilton UK Ltd v Shuttleworth* *[2018] EWHC 911 (Ch)* at [129].

III THE CRITERIA FOR DETERMINING WHETHER PERMISSION WILL BE GRANTED

[14.43]

When hearing an application for permission there are two possible problems for a judge; they both mirror those applying in applications for interim injunctions[1]. First, there is usually no oral evidence and no opportunity for cross-examination or disclosure; inspection of documents has not taken place, and sometimes no points of claim or points of defence have been drafted and/or served[2], so that the judge does not have before him or her, in many instances, the full story or, at least, a tested full story. Secondly, a judge hearing an application for permission cannot devote the same time to it as the trial judge can, if and when the case is finally heard in full. It is critical that applications for permission are not overly-long, and that the substantive issues are not pre-judged, given the absence of evidence from the company and the uncontested nature of the first stage, because even if the judge directs the company to submit evidence, there is no suggestion that the company will argue the substantive points at this juncture. The company might not in fact wish to divulge its case at this point.

[1] The equivalent test in Australia is used in deciding interim injunction applications: *Charlton v Baber [2003] NSWSC 745*, *(2003) 47 ACSR 31* at [55]; *Reale v Duncan Reale Pty Ltd [2005] NSWSC 174* at [11].

[2] D Bean *Injunctions* (5th edn, 1991) at 23.

[14.44]

The Law Commission in its *Shareholder Remedies* report was most concerned that mini-trials were avoided at preliminary hearings as they could be lengthy and, thus, costly[1]. The concern that it had was that a threshold test on the merits might well lead to fine distinctions being drawn as to which side of the line a particular set of facts fell[2]. It favoured the development of a principled approach that was not tied to a particular rule[3].

[1] Law Commission, *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at para 6.71.

[2] Law Commission, *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at para 6.72.

[3] Law Commission, *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at para 6.72.

[14.45]

On the point of length, the concern of the Law Commission does not seem to have been addressed as some of the cases for permission that have been heard under the statutory scheme have lasted several days[1], and, consequently, led to the incurring of significant costs. So this is of some concern. David Donaldson QC (sitting as a deputy judge of the High Court) in *Langley Ward Ltd v Trevor* (sub nom *Re Seven Holdings Ltd*)[2] indicated his concern about permission hearings becoming time-consuming when he said[3]:

> "In the present case, the court was presented with three lever-arch files of pleadings, statements and documents in addition to detailed skeleton arguments and extensive lists of authorities. The argument before me was contained within a day, but only as the result of extensive (and underestimated) pre-reading by the court and the submission and consideration of supplementary skeletons on an important point after the hearing."

[1] For instance, the hearing in *Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch), [2010] BCC 420* at [79] lasted for five days.

[2] *[2011] EWHC 1893 (Ch)*.

[3] [2011] EWHC 1893 (Ch) at [61].

[14.46]

Generally cases will be decided on the documentary evidence presented to the court, as is the situation usually with interim injunction applications and the general practice of the Chancery Division, but, on occasions, in Australia, courts have permitted oral evidence to be given in leave applications, and they have permitted cross-examination of the applicant[1]. However, it must be noted that, in contrast to applications for interim injunctions, the proceedings for permission are not interlocutory, but final[2]. Having noted these problems we now move on to consider the criteria that is set down by the legislation for determining whether permission should be granted. Some warrant little comment while others demand detailed discussion.

[1] For example, see *Talisman Technologies Inc v Qld Electronic Switching Pty Ltd [2001] QSC 324* at [24].

[2] *Swansson v Pratt [2002] NSWSC 583, (2002) 42 ACSR 313* at [24]; *Reale v Duncan Reale Pty Ltd [2005] NSWSC 174* at [11]; *Ehsman v Nucetime International Pty Ltd [2006] NSWSC 887* at [6].

A Specified criteria which courts must consider

1 Prima facie case

[14.47]

As mentioned earlier, the Law Commission in its *Shareholder Remedies* report was most concerned to avoid mini-trials at preliminary hearings[1]. For this reason it was against the introduction of a threshold requirement. It was concerned that if there were a threshold test it might well lead to fine distinctions being drawn as to which side of the line a particular set of facts fell[2]. It favoured the development of a principled approach that was not tied to a particular rule[3]. Nevertheless the Act did include a threshold requirement as Parliament believed that it could prevent a plethora of proceedings being brought by every disenchanted individual in the country[4]. This is the first stage in getting permission. It involves a court being satisfied that the shareholder has a prima facie case that warrants the court granting permission to bring proceedings[5], namely that there is a prima facie case that the company has a good cause of action and also that the cause of action arises out of a director's default, breach of duty etc[6]. It has been indicated that the aim of the first stage is to assess whether the company and the defendant should be put to the expense and inconvenience of considering and contesting the application for permission[7]. In *Langley Ward Ltd v Trevor* (sub nom *Re Seven Holdings Ltd*)[8] David Donaldson QC (sitting as a deputy judge of the High Court) said that to enable the court to do this it is incumbent on the applicant:

> "to set out clearly and coherently the nature and basis of each claim together with the supporting evidence and legal basis. It must also draw the attention of the court squarely to any legal and evidential difficulties and to any fact at odds with its contentions. The same open, clear and

frank approach must be adopted by the applicant as regards the factors which the court is required or may reasonably be expected to take into account in deciding whether it must, or ought to, refuse permission.[9]"

[1] Law Commission, *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at para 6.71.

[2] Law Commission, *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at para 6.72.

[3] Law Commission, *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997).

[4] HL Debate, 9 May 2006, vol 681, col 885, Lord Sharman.

[5] Companies Act 2006, s 261(2).

[6] *Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch), [2010] BCC 420* at [78].

[7] *Langley Ward Ltd v Trevor [2011] EWHC 1893 (Ch)* at [62].

[8] *Langley Ward Ltd v Trevor [2011] EWHC 1893 (Ch)*

[9] *Langley Ward Ltd v Trevor [2011] EWHC 1893 (Ch)*.

[14.48]

Persuading a court that he or she has a prima facie case is the first stage that an applicant/claimant has to address. The prima facie test is familiar to lawyers and was the primary test in applications for interim injunctions in most cases during the first three-quarters of the last century[1], and is still invoked in some injunction hearings today. This was also a preliminary matter that has to be established in derivative proceedings at common law[2].

[1] For example, see *Hoffman-La Roche (F) & Co v Secretary of State for Trade & Industry [1975] AC 295* at 338, 360; *Cavendish House (Cheltenham) Ltd v Cavendish-Woodhouse Ltd [1970] RPC 234 (CA)*. The test was not applied across the board. In some cases the test was not employed as courts wanted to retain flexibility. See, *Hubbard v Vesper [1972] 1 All ER 1023*.

[2] *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204* at 221. For greater discussion of the position of decisions on the issue of the prima facie grounds for derivative actions at common law, see A Keay and J Loughrey 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action Under the Companies Act 2006' (2008) 124 LQR 469; A Keay and J Loughrey 'An assessment of the present state of statutory derivative proceedings' in J Loughrey (ed) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar, 2013), Chapter 7; A Reisberg *Derivative Actions and Corporate Governance* (OUP, 2007).

[14.49]

Notwithstanding the familiarity of the prima facie case test, the meaning of the concept remains somewhat elusive[1]. Courts have not, either in applications for leave at common law or in injunction applications, discussed in detail the meaning of the term. Neither have the courts stated what exactly an applicant must do to establish a prima facie case[2]. The suggestion has been made that an applicant is required to demonstrate that a claim has a substantial chance of success in the final hearing[3]. This indicates that it is inevitable that there is some evaluation of the ultimate merits of the case. In injunction hearings, the use of the prima facie case test led to the court focusing on the relative strengths of the parties' cases and, often, involved a virtual

trial within a trial. In order to establish a prima facie case an applicant in injunction applications had to establish a greater than 50 per cent chance of success[4]. But it would seem that the courts did not interpret the requirement strictly at common law and they continued this approach under the statutory regime, and, hence, it was not and is not a stiff test to pass, given the evidence we have from the case law. The number of reported judgments on leave applications, and on derivative actions more generally, prior to the advent of the CA 2006, is small but, of these, there are few in which a shareholder has failed to establish a prima facie case. Where leave was granted, in three cases the applications were unopposed or the defendants conceded that there was a prima facie case[5], in two the evidence against the defendant was strong enough to support an application for summary judgment, and therefore more than satisfied the threshold test of a prima facie case[6], while in others, such as reports of trials of derivative actions, the grant of leave was referred to only in passing, if at all[7].

1 *American Cyanamid Co v Ethicon Ltd* *[1975] AC 396* at 404. See A Keay, 'W[h]ither American Cyanamid?: Interim Injunctions in the Twenty-First Century' (2004) 23 *Civil Justice Quarterly* 132.

2 C Gray 'Interim Injunctions since American Cyanamid' (1981) 40 CLJ 307 at 307.

3 J Heydon and P Loughlan *Cases and Materials on Equity and Trusts* (Butterworths, 5th edn, 1997) at 978.

4 *American Cyanamid Co v Ethicon Ltd* *[1975] AC 396* at 406–407.

5 *Halle v Trax BW Ltd [2000] BCC 1020* at 1023; *Fansa v Alsibahie [2005] EWHC 299 (Ch)*, *[2005] All ER (D) 80 (Jan)*; *Airey v Cordell [2006] EWHC 2728 (Ch)*, *[2007] Bus L R 391* at [68].

6 *Fayers Legal Services Ltd v Day [2001] All ER (D) 121 (Apr)* at [4]; *Bracken Partners Ltd v Gutteridge [2003] EWHC 1064 (Ch)*, *[2003] 2 BCLC 84*.

7 *Knight v Frost [1999] 1 BCLC 364*; *Qayoumi v Oakhouse Property Holdings Plc [2002] EWHC 2547 (Ch)*, *[2003] 1 BCLC 352*; *Gidman v Barron [2003] EWHC 153 (Ch)*; *Fraser v Oystertec Plc [2003] EWHC 2787 (Ch)*, *[2004] BCC 233* at [20] (summary judgment application), though in a subsequent application to amend the company's claim, the court considered that permission should be withdrawn as there no longer appeared to be wrongdoer control and the company had succeeded on much of its claim: *Fraser v Oystertec Plc (Proposed Amendments) [2004] EWHC 2225 (Ch)*, *[2005] BPIR 389* at [32]–[33].

[14.50]

Both before and after the introduction of the statutory scheme, in situations where leave has been refused, a prima facie case on the merits has often been established, but the application has failed because of other reasons[1], or the failure to establish a prima facie case ended up not being the sole reason for the refusal of leave. One of the cases at common law was *Smith v Croft (No 2)* where Knox J was influenced by a report from the company's auditors, which had been commissioned by the board to investigate the shareholders' complaints, and which concluded that most of the complaints were unfounded[2]. Also, in *Harley Street Capital Ltd v Tchigirinski (No 2)*[3], independent third party evidence that refuted the shareholder's allegations was led. The company, on the directions of the court, had commissioned a report by an independent firm of solicitors into the minority shareholder's allegations of wrongdoing. No evidence of wrongdoing was found and, furthermore, the shareholder was unable to advance evidence of any[4]. For these reasons, and because the shareholder lacked bona fides, the action was struck out as an abuse of process[5].

1 *Barrett v Duckett [1995] BCC 362*, 364; *Portfolios of Distinction Ltd v Laird [2004] EWHC 2071 (Ch)*, *[2005] BCC 216* at [64]; *Mumbray v Lapper [2005] EWHC 1152 (Ch)*, *[2005] BCC 990* at [21]–[24] and all cases after the introduction of the statutory scheme.

2 *Smith v Croft (No 2) (1988) Ch 114* at 150–154. *Jafari-Fini v Skillglass [2005] EWCA Civ 356*, *[2005] BCC 842* may be another such case, though this was not the expressed reason for the refusal of leave.

3 *[2005] EWHC 2471 (Ch)*, *[2006] BCC 209*.

4 [2005] EWHC 2471 (Ch), [2006] BCC 209 at [116]–[118].

5 [2005] EWHC 2471 (Ch), [2006] BCC 209 at [141].

[14.51]

Overall it would seem that courts have not expected a great deal from applicants and this is supported further by the fact that applicants for permission have been required to submit only fairly basic evidence in order to establish a prima facie case. Reed has argued[1] that under the common law system the claimant needed only to support the application for permission with written evidence, and this meant that in practice the supporting evidence did little more than verify the facts on which the claim and the entitlement to sue on behalf of the company were founded. Under the CA 2006 the first stage is decided on the basis of the applicant's written evidence only[2], (though the applicant can request an oral hearing if the application is initially unsuccessful)[3], and the courts have generally adopted a similarly undemanding approach to weighing that evidence and assessing whether there is a prima facie case.

1 R Reed 'Derivative Claims: The Application for Permission to Continue' (2000) 21 Co Law 156 at 156.

2 Confirmed in *Langley Ward Ltd v Trevor (sub nom Re Seven Holdings Ltd)* [2011] EWHC 1893 (Ch); *Cinematic Finance Ltd v Ryder [2010] EWHC 3387 (Ch), [2012] BCC 797* at [2] and envisaged by the CPR 19.9A(9).

3 CPR 19.9A(10).

[14.52]

In sum, at common law or under the statutory scheme the requirement to show a prima facie case on the merits appears not to have been a demanding obstacle for shareholders to negotiate. This is because, at the initial stage, the company plays no part, and the application is assessed on the basis of the shareholder's evidence alone. In so far as the need for the courts to give guidance on how to assess whether a shareholder has met this criterion, the cases under the statutory scheme have provided little assistance as they have not given us a lot of reasoning. But the same could be said about the cases that were heard under the common law derivative action.

[14.53]

We now turn to considering what the case law following the introduction of the statutory scheme has said. It is fair to say that the cases so far have not been clear or consistent regarding what exactly the first stage of the process requires. On appeal to the Inner House of the Court of Session in the Scottish case of *Wishart v Castlecroft Securities Ltd*[1], the court seemed to require only a low threshold for the applicant to get over. The court said that 'the question is not whether the application and supporting evidence disclose a *prima facie* case against the defenders to the proposed derivative proceedings, but whether there is no prima facie case disclosed for granting the application for leave [permission in England]'. Their Lordships went on to say that the applicant should not carry the burden of satisfying the court that he or she has a prima facie case, but rather there should be refusal if the court is satisfied that there is not a prima facie case, and it specified the matters which it thought must be taken into account[2]. It firstly dealt with some very formal elements with which the court must be satisfied, namely ensuring that the applicant is a member of the company involved, whether the application relates to derivative proceedings, and that the application specified the cause of action and facts on which the derivative proceedings are based[3]. But it also added that the courts should consider the factors that are set out in s 268(1), (2) and (3) (equivalent to s 263(2) and (3) for the rest of the UK) in order to determine whether the application should be granted. This means that the first stage might be seen as being more difficult to get through than the legislation seems to provide for, and more difficult than

was the case at common law. This approach also appeared to be taken in *Stimpson v Southern Landlords Association*[4], by HH Judge Pelling QC (sitting as a judge of the High Court). His Lordship said that:

> "If the statute is followed strictly, the court is required to consider whether a prima facie case is established – see s 261(2). In considering that question the court is bound to have regard, not merely to the factors identified in s 263(3) and (4), but to any other relevant consideration since s 263(3) and (4) are not exhaustive.[5]"

[1] *[2009] CSIH 65*, *2009 SLT 812* at [31]. See *Wishart, Petitioner [2009] CSOH 20*, *2009 SLT 376* for the decision at first instance. While the appeal court disagreed with the approach taken at first instance, it came to the same result.

[2] [2009] CSIH 65, 2009 SLT 812 at [31].

[3] The last requirement is peculiar to the provisions applying in Scotland. See s 266(2).

[4] *[2009] EWHC 2072 (Ch)*, *[2010] BCC 387*.

[5] [2009] EWHC 2072 (Ch), [2010] BCC 387 at [46].

[14.54]

In neither of the cases referred to in the previous paragraph was the court's ultimate decision on the application before it made on the basis of whether it was satisfied that the applicant had a prima facie case. But the comments that were made in each case do cause some concern in that they appear to set the bar far higher than would have been envisaged. With respect, there is nothing in the legislation either applying to England and Wales and Northern Ireland on the one hand and Scotland on the other, suggesting that the factors in s 263 (in England) must be addressed at the first stage. There is no connection in the legislation between s 261 on the one hand and s 263 on the other. Furthermore, the Law Commission only recommended one stage, which is the second stage provided for in the legislation. The Law Commission in fact expressed concern 'at the way [at common law] in which a member was required to prove standing to bring an action as a preliminary issue by evidence which shows a prima facie case on the merits'[1]. The main reason for the Law Commission not recommending a preliminary stage was that 'the inclusion of an express test would increase the risk of a detailed investigation into the merits of the case taking place at the leave stage, and that such a “mini-trial” would be time consuming and expensive'[2]. In *Singh v Singh*[3] Vos LJ said that: 'The conducting of a mini trial even where the legislation demands something that looks rather like a mini trial is not desirable even if required'[4]. Obviously at the second stage where the company can appear and produce evidence, a court has to take into account the s 263 factors. But suggesting that they are relevant at the first stage makes the first stage potentially far more substantial than it should be, particularly when one considers the position that existed prior to the enactment of the statutory derivative regime. No other cases have included reference to s 263 factors in the same breath as the prima facie criterion. Given consideration of the whole paragraph of HHJ Pelling QC's judgment in *Stimpson* and partly quoted above, it is questionable whether his Lordship was in fact intending to make the prima facie criterion a hard one to get over. But that still leaves us with the *Wishart* judgment. Generally speaking, the courts have let claims through the first stage without too much inquiry, it would seem, and have not employed a substantial bar to get over.

[1] The Law Commission only recommended one stage: *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com. No 246, Cm 3769) (London: Stationery Office, 1997) at para 6.4.

[2] Law Commission, *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London: Stationery Office, 1997) at para 6.71.

[3] *[2014] EWCA Civ 103*.

4 [2014] EWCA Civ 103 at [29].

[14.55]

The regime seems to envisage that there will only be a substantial hearing at the second stage and not at the first, with the second being inter partes. But the *Wishart* judgment suggests two substantial hearings, and it causes one to ask what the difference is between the two stages, because the factors in s 263(2), (3) and (4) clearly have to be considered at the second stage. In fact, if there is a difference it would appear that the first stage is tougher than the second for a court must, at the first stage, consider the issue of 'prima facie case' besides those matters set out in s 263(2), (3) and (4), if the *Wishart* approach applies. But while the *Wishart* decision has been mentioned by several cases the approach the case seemed to put forward, and noted in 14.53, has not been expressly adopted. It might be thought that with such an approach the reference to 'prima facie case' in s 261 is otiose for if a court takes the view that the applicant succeeds under the s 263 factors he or she clearly would have a prima facie case. It is worth noting that the first stage was added to the legislation late in the process, in the House of Lords, and this might be an indication that what the first stage actually involved was not thought through sufficiently.

[14.56]

What is interesting is that several judges appear to have approved of the virtual telescoping of the two stages within the process if the parties are in agreement, with the result that there is just the one hearing[1]. This might well be sensible in some cases, but we must bear in mind the caveat sounded by David Donaldson QC (sitting as a deputy judge of the High Court) in *Langley Ward Ltd v Trevor*, some of which was mentioned earlier[2]:

> "The inclusion in the Companies Act of an ex parte stage provides a hurdle and filter which in my view should not be dispensed with. As with any ex parte application the matter should be presented and explained transparently and fairly so that the court can make a properly informed decision whether it is right to put the company (and the potential defendant) to the expense and inconvenience of considering and contesting the application. This can only be achieved if the applicant sets out clearly and coherently the nature and basis of each claim together with the supporting evidence and legal basis. It must also draw the attention of the court squarely to any legal and evidential difficulties and to any fact at odds with its contentions. The same open, clear and frank approach must be adopted by the applicant as regards the factors which the court is required or may reasonably be expected to take into account in deciding whether it must, or ought to, refuse permission. All this is particularly important since the legislation contemplates that its preliminary examination will be done by the court solely on the papers.[3]"

1 *Wishart* [2009] CSIH 65*, 2009 SLT 812* at [9]. For examples, see *Mission Capital Plc v Sinclair* [2008] EWHC 1339 (Ch); *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch)*, [2008] BCC 885*; *Stimpson v Southern Landlords Association* [2009] EWHC 2072 (Ch)*, [2010] BCC 387*; *Parry v Bartlett* [2011] EWHC 3146 (Ch)*, [2012] BCC 700.*

2 [2011] EWHC 1893 (Ch).

3 [2011] EWHC 1893 (Ch) at [62].

[14.57]

In this case the structure of the statutory process was, in the words of the deputy judge, 'undermined'[1], as the matter did not pass through the ex parte stage; it was effectively bypassed. If it had been subject to the first stage, then, according to the deputy judge, a large number of the claims, and perhaps all of them, would

have been eliminated at that point[2]. The case proceeded on the assumption that the judge was hearing the matter at the second stage. Clearly the danger with telescoping is the fact that a case could go on for much longer than it should, when it could have been either dismissed or the issues with which it was concerned, refined, at the first stage of the process.

1 *Langley Ward Ltd v Trevor [2011] EWHC 1893 (Ch)* at [6].

2 *Langley Ward Ltd v Trevor [2011] EWHC 1893 (Ch)* at [63].

[14.58]

The view of Roth J in *Stainer v Lee*[1] and HH Judge Davis-White QC (sitting as a judge of the High Court) in *Wilton UK Ltd v Shuttleworth*[2] was that a court is able to revise its view as to whether there is a prima facie case at the second stage, once it has received evidence and argument from the respondents. If that is the case then it would seem that a court could decline to consider the factors that have to be considered at the second stage if the court believes, at the second stage, that in fact there is not a prima facie case after all[3].

1 *[2010] EWHC 1539 (Ch), [2011] BCC 134* at [29].

2 *[2018] EWHC 911 (Ch)* at [59], [60].

3 [2010] EWHC 1539 (Ch), [2011] BCC 134 at [29].

[14.59]

It is submitted that the first stage should be limited to making sure that a claim has some substance to it, and should involve the court ensuring that the applicant is a member of the company and the application relates to derivative proceedings, as required by the court in *Wishart*. There might be a case in some situations for the delineation of the issues, as envisaged by David Donaldson QC in *Langley Ward Ltd v Trevor*[1].

1 *[2011] EWHC 1893 (Ch)* at [63].

[14.60]

If the court is not satisfied that there is a prima facie case then the claim will be dismissed. If the shareholder succeeds, then the application for permission will proceed to the second stage when the court will direct the company to file evidence indicating why permission to proceed should be refused[1], and the court has to decide whether the application should actually be granted[2]. As mentioned earlier, if a judge does not think, on the papers, that there is a prima facie case the applicant/claimant may ask, under CPR 19.9A(10), for an oral hearing before the judge. The rule does not say to whom the request is made, but it might be assumed that it is to the judge who declined the application. One assumes that as the provision refers to 'asking' for a hearing, a judge may refuse to accede to the request if he or she thinks that it is not appropriate.

1 Companies Act 2006, s 261(3).

2 *Wishart [2009] CSIH 65, 2009 SLT 812* at [33].

[14.61]

While there is merit, as highlighted by David Donaldson QC in *Langley Ward Ltd v Trevor*[1], in having a threshold requirement, one concern is that it might not deter the submission of long witness statements and large bundles as practitioners acting for the applicant/claimant might be concerned that if they do not include everything that they have there is always the chance that a judge will not let the application through to the second stage, especially given the fact that the burden of proof is not all that clear. Some have suggested that the approach of the courts is to allow claims to go to the second stage provided that there is something in the claim and they can always be knocked out at the second stage[2]. It might be thought that it is a waste of time and resources taking too much time on the first stage since the second stage could fulfil the purpose of the process of permission[3]. However, matters should not be let through to the second stage as a matter of course as that could mean a waste of time for the courts and a large costs bill for the parties.

1 *Langley Ward Ltd v Trevor [2011] EWHC 1893 (Ch)*.

2 B Hannigan and D Prentice, *Hannigan and Prentice's The Companies Act 2006 – A Commentary* (Lexis Nexis, London, 2007) at para 4.46 and referred to in J Tang, 'Shareholder remedies: demise of the derivative claim?' (2012) 1 *UCL Journal of Law and Jurisprudence* 178 at 183.

3 J Tang 'Shareholder remedies: demise of the derivative claim?' (2012) 1 *UCL Journal of Law and Jurisprudence* 178 at 184.

[14.62]

Whatever way we look at the authorities it would seem that so far we can say that this first stage is one that is reasonably easy to traverse.

2 Elements as to which the court must be satisfied

[14.63]

If an applicant/claimant is adjudged to have a prima facie case, the court then has to move to the second stage of the permission process. The second stage begins with consideration of s 263(2) of the CA 2006. This subsection provides that a court *must* refuse permission if it is satisfied in relation to any one of the following three matters:

- a person acting in accordance with s 172 would not seek to continue the claim; or
- the claim relates to an act or omission that has not occurred as yet and it has been authorised by the company; or
- the claim relates to an act or omission that has occurred and it was authorised by the company before it occurred or it has been ratified since it occurred.

[14.64]

If any one or more of these apply then the application fails. There is no discretion given to the courts if any one of the criteria is fulfilled. If none of these apply then the court has a discretion under s 263(3) and (4) as to whether to allow the claim to proceed. More about this shortly.

[14.65]

It has been said that there was no particular standard of proof that has to be satisfied in relation to the elements in s 263(2)[1]. In *Iesini v Westrip Holdings Ltd*[2] Lewison J (as he then was) held that something more

than simply a prima facie case must be needed since that forms the first stage of the procedure; and that while it would be wrong to embark on a mini-trial the court must form a view on the strength of the claim, albeit on a provisional basis.

1 *Stainer v Lee [2010] EWHC 1539 (Ch), [2011] BCC 134* at [29].

2 *[2009] EWHC 2526 (Ch), [2010] BCC 420.*

[14.66]

In *Stainer v Lee* the judge said that a court can grant permission even if it is not satisfied that there is a strong case, if the amount of potential recovery is very large[1]. However, it is unlikely, given what most of the cases have said, if a decision will ever depend solely on this one issue. The courts seem to favour undertaking a risk/benefit analysis[2]. While the merits of the claim will be relevant to whether permission should be given, they will not be decisive as there is no set threshold[3]. But obviously the merits will have a bearing on some matters, such as that found in s 263(2)(a), namely whether a director acting in accordance with s 172 would seek to continue the action[4].

1 [2010] EWHC 1539 (Ch), [2011] BCC 134 at [29].

2 For instance, see, *Zavahir v Shankleman [2016] EWHC 2772 (Ch), [2016] BCC 500* at [39].

3 *Kleanthous v Paphitis [2011] EWHC 2287 (Ch), [2012] BCC 676* at [42].

4 *Kleanthous v Paphitis [2011] EWHC 2287 (Ch), [2012] BCC 676* at [45].

[14.67]

As far as the first element is concerned, located in s 263(2)(a)[1], a court is to refuse permission if it is satisfied that a person acting in accordance with s 172 would not seek to continue the claim. Section 172(1) provides that directors have a duty to promote the success of the company. The meaning, operation and interpretation of s 172 were discussed extensively in CHAPTER 6. What the provision requires the directors to do is to do that which they consider, in good faith, is most likely to promote the success of the company for the benefit of the members as a whole, and in doing this they must have regard for several factors set out in s 172(1)(a)-(f). These factors are set out and discussed in CHAPTER 6. The operation of s 172 has not been considered in depth by any court and there remains uncertainty with the provision, as discussed in CHAPTER 6, but this does not seem to have impeded the courts in their consideration of this criterion. The judges in most of the permission hearing judgments have spent some time considering the criterion. For example, in *Franbar Holdings Ltd v Patel*[2] the judge took the view that he could not be satisfied that a director acting in accordance with s 172 would believe that the case did not warrant continuation[3]. So, the application could not be knocked out on this ground in that case. And in many cases this has been the criterion that has meant all the difference.

1 For greater discussion of this criterion, see A Keay 'Applications to Continue Derivative Proceedings on Behalf of Companies and the Hypothetical Director Test' (2015) 34 *Civil Justice Quarterly* 346.

2 *[2008] EWHC 1534 (Ch), [2008] BCC 885.*

3 [2008] EWHC 1534 (Ch), [2008] BCC 885 at [30].

[14.68]

Decisions under the common law raised the possibility that the courts may require very clear evidence that a person under a duty to promote the success of the company would not pursue the action, or would not consider it sufficiently important to pursue, before refusing leave on this basis. In *Mumbray v Lapper*[1] the test under the common law for the grant of permission to bring derivative proceedings was said to be whether an independent board would sanction the pursuit of the proceedings[2]. This seems very similar to the requirement in s 263(3)(b) of the CA 2006. In the case itself the test was not explored further, and permission was refused because alternative remedies existed, as well as the fact that the shareholder had participated in wrongdoing[3]. However, in *Airey v Cordell*[4], the test was applied in a manner which could have significant implications if it were to be adopted by courts interpreting the CA 2006.

1 *[2005] EWHC 1152 (Ch), [2005] BCC 990.*

2 [2005] EWHC 1152 (Ch), [2005] BCC 990 at [5]. The test is drawn from earlier case law dealing with whether the court should order the company to indemnify the shareholder's costs: see *Wallersteiner v Moir (No 2) [1975] QB 373* at 404 (Buckley LJ); *Smith v Croft (No 1) [1986] 1 WLR 580* at 590; *Jaybird Group Ltd v Greenwood [1986] BCLC 319* at 321.

3 [2005] EWHC 1152 (Ch), [2005] BCC 990 at [21]–[23].

4 *[2006] EWHC 2728 (Ch), [2007] Bus LR 391.*

[14.69]

In *Airey v Cordell* Warren J stated that 'there is a range of reasonable decisions' that a board might make, so that a reasonable board could take a decision either way[1]. He went on to say that shareholders would fail this test only if the court took the view that no board acting reasonably would sanction the action. Provided that the shareholder's decision was one which a reasonable board could take, the court should give permission to proceed even though another board could reasonably refuse to prosecute the action[2]. This was because it would not be 'right to shut out the minority shareholder on the basis of the court's, perhaps inadequate, assessment of what it would do rather than a test which is easier to apply, which is whether any reasonable board could take that decision'[3].

1 *[2006] EWHC 2728 (Ch), [2007] Bus LR 391* at [69].

2 [2006] EWHC 2728 (Ch), [2007] Bus LR 391 at [75].

3 [2006] EWHC 2728 (Ch), [2007] Bus LR 391.

[14.70]

It has been noted that this approach is similar in many respects to the range of reasonable responses test in employment law[1]. In assessing a claim for unfair dismissal under s 98(4) of the Employment Rights Act 1996, the tribunal will not hold an employer liable if his or her actions fall within a range of responses which a reasonable employer might have taken, even though the dismissal could be seen as a harsh decision that is at the extreme end of a band of reasonable responses[2]. What is behind this is the fact that the courts are reluctant to second guess and set aside management decisions; however, it has been subject to criticism on the basis that employers' decisions will not be overturned unless they exhibit a standard of unreasonableness which equates to perversity[3]. Some might feel that such an approach would not be defensible in derivative action applications. While an interventionist approach in dismissal cases would lead to the courts interfering in management decisions, and so arguably justifies the range of reasonable responses test, this is not so in the case of derivative actions. Here it is the decision of a shareholder, not management, to sue that is scrutinised. Given that management has presumably opposed the action, allowing it to proceed would constitute interference with management's judgment, and the litigation itself could interfere with the running of the company's business. Some courts might be most reluctant to do so.

[1] A Keay and J Loughrey 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action Under the Companies Act 2006' (2008) 124 LQR 469 at 494.

[2] A Keay and J Loughrey 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action Under the Companies Act 2006' (2008) 124 LQR 469 at 494 and referring to *Iceland Frozen Foods v Jones [1982] ICR 17*; *Post Office v Liddiard [2001] EWCA Civ 940*, [2001] *Employment Law Review* 78. Although the EAT in *Beedell v West Ferry Printers Ltd [2000] ICR 1263* at 1278–1279 stated that this was not a test of perversity equating it instead with the *Bolam* test (*Bolam v Friern Management Committee [1957] 2 All ER 118*), which is the standard of care test in professional negligence cases, this test has also been extensively criticised as causing courts to adopt an unduly non-interventionist approach, and resulting in very few findings of negligence against professionals.

[3] A Keay and J Loughrey 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action Under the Companies Act 2006' (2008) 124 LQR 469 at 494, and referring to A Freer 'The Range of Reasonable Responses Test-From Guidelines to Statute' (1998) 27 *Industrial Law Journal* 335 at 335–336.

[14.71]

Nevertheless, it might be possible to argue that a reasonable responses test should be employed under the CA 2006. This is because it would apply to only one of the criteria that the courts have to take into account in determining whether to grant permission. Given that assessing whether a person under a duty to promote the success of the company would or would not seek to continue a claim does involve the courts attempting to form a view in relation to the commercial wisdom of the litigation, the test would relieve them of carrying out a task that lies outside of their normal role, and that they are not well equipped to carry out[1]. It would require them to refuse permission on this basis only in the most obvious cases, where, for example, pursuing the action 'was wholly disproportionate and cost-ineffective'[2]. At the same time, applications could continue to be screened out applying the other permission criteria.

[1] H C Hirt 'The Company's Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest' (2005) JBL 159, 165–166 and 195–196.

[2] *Airey v Cordell [2006] EWHC 2728 (Ch)*, *[2007] Bus L R 391* at [69] per Warren J, though it should be noted that the judge was prepared to refuse leave if a suitable alternative remedy became available: at [83]–[86].

[14.72]

There is no particular standard of proof that has to be satisfied in relation to the elements in s 263(2)(a)[1]. In *Hughes v Weiss*[2] HHJ Keyser QC (sitting as a judge of the High Court) said that there was no particular merits test that had to be satisfied before permission will be granted. Put somewhat differently, but conveying the same meaning, Newey J in *Kleanthous v Paphitis*[3] stated that the derivative actions statutory scheme does not require a specific threshold to be attained before a claim is to be allowed to continue[4]. This is consistent with the Law Commission's 1996 recommendation that there should be no threshold so as to avoid any risk of a detailed investigation of the merits of the claim at the permission stage[5]. In fact s 263(2)(a) seems to provide a fairly low threshold that has to be passed. The reason is that, according to the court in *Iesini v Westrip Holdings Ltd*[6] that just as with the approach taken by the court in *Airey v Cordell*[7] when dealing with the position applying at common law, a court should only refuse permission where *no* director would seek to continue the claim. In *Franbar Holdings Ltd v Patel*[8] William Trower QC (sitting as a deputy judge of the High Court) (as he then was) adopted a similar approach when assessing what a person under a duty to act in accordance with s 172 would do[9], as did the appeal court in *Wishart*[10], Roth J in *Stainer v Lee*[11], HH Judge Keyser QC in *Hughes v Weiss*[12], David Donaldson QC (sitting as a deputy High Court judge) in *Langley Ward Ltd v Trevor*[13] and HH Judge Hodge QC (sitting as a High Court judge) in *Singh v Singh*[14]. With this approach it is relatively easy for shareholders to demonstrate that the hypothetical decision-maker would sanction the action. It would be uncommon, one would think, that a derivative action was so obviously undesirable that no reasonable decision maker acting in the company's interests would sanction it, and in *Zavahir v Shankleman*[15] John Baldwin QC (sitting as a deputy judge of the High Court) said that if some directors

might and some might not continue an action it would be necessary to consider the matter under s 263(3)(b), and this is consistent with what was said by HH Judge Davis-White QC (sitting as a High Court judge) in *Wilton UK Ltd v Shuttleworth*[16] and judges in several earlier judgments, such as Lewison J in *Iesini*[17]. However, there have been cases where courts have felt that the case of the applicant was so weak that no director would seek to continue the claim. A clear example is *Iesini*[18], and this effectively was also the case in *Stimpson v Southern Landlords Association*[19]. In *Brannigan v Style*[20] Aplin J was of the view that whether no reasonable director would continue the action was borderline and she therefore considered the issues contained in s 263(3). It is likely that when considering this latter criterion, a judge will be swayed by the consequences of what a prudent director undertaking a risk/benefit analysis would conclude[21].

1 For example, see *Wishart* [2009] CSIH 65; *2009 SLT 812*, *[2010] BCC 210* at [40]; *Kleanthous v Paphitis* [2011] EWHC 2287 (Ch), *[2012] BCC 676* at [45].

2 [2012] EWHC 2363 (Ch) at [33] and approved of by HHJ Hodge QC in *Singh v Singh* [2013] EWHC 2138 (Ch) at [17].

3 [2011] EWHC 2287 (Ch) at [40].

4 This was also indicated in *Wishart* [2009] CSIH 65; *2009 SLT 812* at [39], [40].

5 Law Commission, *Shareholder Remedies: Report on a Reference under* section 3(1)(e) *of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London: Stationery Office, 1997) at paras 6.71, 6.72.

6 [2009] EWHC 2526 (Ch), *[2010] BCC 420* at [86].

7 *[2007] BCC 785* at 800.

8 [2008] EWHC 1534 (Ch).

9 [2008] EWHC 1534 (Ch) at [30].

10 [2009] CSIH 65, *2009 SLT 812* at [32].

11 [2010] EWHC1539 (Ch), *[2011] BCC 134* at [28].

12 [2012] EWHC 2363 (Ch) at [45].

13 [2011] EWHC 1893 (Ch) at [9].

14 [2013] EWHC 2138 (Ch) at [18].

15 *[2016] EWHC 2772 (Ch)*, *[2016] BCC 500* at [36].

16 [2018] EWHC 911 (Ch) at [65].

17 [2009] EWHC 2526 (Ch), *[2010] BCC 420* at [85], [86].

18 [2009] EWHC 2526 (Ch), *[2010] BCC 420* at [79], [102].

19 *[2009] EWHC 2072*, *[2010] BCC 387.*

20 [2016] EWHC 512 (Ch) at [74].

21 *Zavahir v Shankleman [2016] EWHC 2772 (Ch)*, *[2016] BCC 500* at [39].

[14.73]

As indicated earlier, *Iesini* provided that something more than simply a prima facie case must be established and while this was not meant to create the need for there to be a mini-trial[1], it is necessary that the court forms a view on the strength of the claim sought to be continued, albeit on a provisional basis[2]. Roth J acknowledged this in *Stainer v Lee* where he said that: 'The necessary evaluation, conducted on … a provisional basis and at a very early stage of the proceedings, is therefore not mechanistic'[3]. In *Cullen Investments Ltd v Brown*[4] Norris J said that he had to form a provisional view of the merits whilst bearing in mind that the evidence was documentary only and had not been tested in cross-examination and there had not been disclosure of documents[5]. The making of a provisional view creates a potential problem for the courts, adverted to by Proudman J in *Kiani v Cooper*[6] when she noted the fact that where, as in the case before her, there are many factual disputes[7]:

> "it is difficult to form a sensible provisional view as to the strength of the evidence on each side. The court is well aware that at trial with proper cross-examination a very different picture may well emerge from that appearing on documentary evidence alone."

1 *Fanmailuk.com Ltd v Cooper [2008] EWHC 2198 (Ch)*, *[2008] BCC 877* at [2]. Also, see *Wishart [2009] CSIH 65*; *2009 SLT 812*, *[2010] BCC 210* at [39]; *Singh v Singh [2014] EWCA Civ 103* at [29].

2 *Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch)*, *[2010] BCC 420* at [79]. This was approved of specifically in *Kleanthous v Paphitis [2011] EWHC 2287 (Ch)*, *[2012] BCC 676* at [45].

3 [2010] EWHC 1539 (Ch) at [29]. This was approved of in *Hughes v Weiss [2012] EWHC 2363 (Ch)*.

4 *[2015] EWHC 473 (Ch)*, *[2015] BCC 539*.

5 [2015] EWHC 473 (Ch), [2015] BCC 539 at [36].

6 *[2010] EWHC 577 (Ch)*, *[2010] BCC 463*.

7 [2010] EWHC 577 (Ch), [2010] BCC 463 at [14].

[14.74]

In *Iesini* the judge said that the kind of factors that a judge would consider in analyzing the application of this criteria are (and not being exhaustive): the size of the claim; the cost of the proceedings; the company's ability to fund the proceedings; the ability of the potential defendants to satisfy a judgment; the impact on the company if it lost the claim and had to pay not only its own costs but the defendant's as well; any disruption to the company's activities while the claim was pursued; whether the prosecution of the claim would damage the company in other ways[1], such as to the company's reputation if the claim was not successful[2]. In *Cullen Investments Ltd v Brown*[3] the fact the applicant shareholder was not seeking any indemnity against costs influenced the judge and he said that given this and other factors it is difficult to see why the hypothetical director would not seek to continue proceedings[4].

1 [2009] EWHC 2526 (Ch), [2010] BCC 420 at [85]. Also, see *Montgold Capital LLP v Ilska [2018] EWHC 2982 (Ch)* at [20].

2 *Iesini [2009] EWHC 2526 (Ch)*, *[2010] BCC 420* at [85]. Also mentioned in *Franbar Holdings [2008] EWHC 1534 (Ch)*, *[2008] BCC 885* at [36] and *Langley Ward Ltd v Trevor [2011] EWHC 1893 (Ch)* at [12].

3 *[2015] EWHC 473 (Ch)*, *[2015] BCC 539*.

4 [2015] EWHC 473 (Ch), [2015] BCC 539 at [55].

[14.75]

Besides these frequently mentioned factors the courts have also addressed other less common factors. In *Langley Ward Ltd v Trevor David*[1] Donaldson QC thought the fact that there was a potential winding up of the company could be a significant factor in whether a director would attach importance to the pursuit of a claim. In this case the judge said that given the company's circumstances it was a natural candidate to be wound up on the just and equitable basis under s 122(1)(g) of the Insolvency Act 1986[2]. One would certainly expect this also to be a consideration where the company is in financial difficulties and there is clear creditor disquiet concerning the company's position, perhaps manifested by demands for payment or refusals to supply goods or services. But while the possibility of a winding up could tell against the continuation of proceedings, it might not always be the case. In some cases the fact that a company has extensive debts outstanding could be a reason for prosecuting an action as a recovery from it could discharge or go some way to discharging the company's debts. The riposte might be that recovery would take some time to achieve and the company's malaise might get worse. While this might indeed be true, except where the case is so strong that the shareholder could obtain summary judgment, creditors might be willing to wait for a resolution of the litigation before pursuing winding-up proceedings if they can be convinced of the likelihood of success of a derivative claim. It should be added that it has been held that permission should not be granted to a shareholder when a company is insolvent[3]. This is probably because the residual beneficiaries of the company are not the shareholder any longer, but the creditors in such circumstances.

1 *[2011] EWHC 1893 (Ch)* at [14].

2 [2011] EWHC 1893 (Ch) at [15].

3 *Cinematic Finance Ltd v Ryder [2010] EWHC 3387 (Ch)*, *[2012] BCC 797*. But cf *Montgold Capital LLP v Ilska [2018] EWHC 2982 (Ch)*.

[14.76]

In considering s 172 in the context of the criterion under discussion HH Judge Keyser QC said in *Hughes v Weiss*[1] that the notion of the success of the company mentioned in that provision, in the circumstances of the case before him, involved consideration of what would be a fair distribution of benefits to its members.

1 *[2012] EWHC 2363 (Ch)* at [54].

[14.77]

It would appear that another factor that might be considered by a court in the context of the issues under discussion is that the applicant/shareholder might be able to institute separate proceedings for unfair prejudice under s 994 of the Act[1]. This is a matter that is discussed in more detail later in the chapter under the heading of 'Alternative remedy'.

1 Something that might also be considered under s 263(3)(f).

[14.78]

It is perhaps worth noting that the approach taken in *Franbar Holdings* seems to mean that a court might take into account a factor mentioned in s 263(3) twice, once in the context of considering what view a hypothetical director might take in relation to continuing the proceedings, and then again separately as a standalone factor, and as required by the provisions of s 263(3). This might seem rather odd, but when deciding what a hypothetical director would do it is necessary for a judge to consider all of the possible issues that a director might well address and to consider the s 263(3) factors from the perspective of a director. When the judge considers them free from having to decide what a director would do he or she then might determine the matter from a more general perspective.

[14.79]

While there is no threshold test, the case law predominantly suggests that the merits will have a bearing on a court deciding both under s 263(2)(a) whether a person acting in accordance with s 172 would seek to continue the action and s 263(3)(b) concerning the importance that would be attached to continuing it[1]. Notwithstanding the fact that the merits are important William Trower QC in *Franbar Holdings Ltd v Patel*[2], said that 'a director will often be in the position of having to make what is no more than a partially informed decision on continuation without any very clear idea of how the proceedings might turn out'[3]. The court in *Wishart* agreed with this latter view as it said that directors ordinarily have to take decisions concerning whether litigation should or should not be commenced 'on the basis of only partial information, without undertaking a lengthy investigation of the merits of the proposed case'[4]. If the judge is to stand in the shoes of a hypothetical director then it would seem that he or she might not delve into all issues in great detail. But this does not seem to be consistent with the fact that it was said in *Franbar Holdings*[5], in addressing the importance to be attached to continuing the action under s 263(3)(b), that the court must find an *obvious* breach of duty.

1 *Kleanthous v Paphitis* *[2011] EWHC 2287 (Ch)*, *[2012] BCC 676* at [45].

2 *[2008] EWHC 1534 (Ch)* at [37].

3 [2008] EWHC 1534 (Ch) at [36].

4 [2009] CSIH 65; 2009 SLT 812 at [37].

5 *[2008] EWHC 1534 (Ch)* at [37].

[14.80]

While the merits of a case appear to have to be considered, it is inappropriate according to *Wishart*[1], for the courts to express any detailed or conclusive view concerning the merits of the prospective action. Nevertheless, *Stimpson v Southern Landlords Association*[2] and *Kleanthous v Paphitis*[3] represent cases where judges considered the merits of the cases, against the potential respondents to a claim, in some depth, and appeared to come to a concluded view[4]. There is clearly some judicial uncertainty as to how far a judge can go in assessing a claim. This can make it difficult for applicants/claimants to know to what extent they are required to develop a case before seeking permission. While the courts have indicated, when considering s 263(3)(b), that they must take into account the fact that directors would not necessarily expect an 'iron-clad' case before instituting proceedings, the case law does suggest that a shareholder has to demonstrate a case that is more convincing than that which is presented to a director when he or she comes to a decision concerning the institution of proceedings.

1 *[2009] CSIH 65*; *2009 SLT 812* at [43].

2 *[2009] EWHC 2072*, *[2010] BCC 387.*

3 *[2011] EWHC 2287 (Ch)* at [45]–[68].

4 [2011] EWHC 2287 (Ch) at [29]–[33]. The judge looked at the likelihood of liability of the directors under ss 172, 175 and 176 of the Act.

[14.81]

Generally when considering the issue of permission the focus is on s 172(1). But in addition to s 172(1), s 172(3) might be considered by a judge in the context of s 263(2)(a) and, for that matter, under s 263(3)(b). Section 172(3), and considered in the last chapter, provides that the duty set out in s 172(1) is subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors. Thus, in certain cases the obligation in s 172(3) trumps the duty in s 172(1)[1]. This is when a company is insolvent or in financial difficulties[2]. From the evidence before the court in a permission hearing it might be argued that the company is in financial difficulties and thus it is subject to s 172(3). While an action might be seen as viable under s 172(1) it might not be under s 172(3). The board might legitimately be concerned that, in exercising its duty under s 172(3), an action is not in the best interests of the creditors because the costs involved could reduce the funds of the company to which the creditors are entitled. If the circumstances that require directors to act pursuant to s 172(3) exist, then why would shareholders be interested in pursuing a derivative action? If the company was in financial distress the shareholders might realise that their interest in the company was worthless or close to it, but if an action were successful, and it was a substantial claim, it might save the company and even produce dividends. Of course, in this type of situation a court might decide that a person acting in accordance with s 172 might not take action as the cost of it, together with the risk of failure, might reduce the amount of money that is available for creditors ultimately, and so an action would not be in the interests of the creditors. The issue was touched on in *McAskill v Fulton*[3] where Norris J felt said that the primary interests involved were those of the creditors[4].

1 For consideration of this, see A Keay 'Directors' Duties and Creditors' Interests' (2014) 130 LQR 443.

2 See A Keay *Company Directors' Responsibilities to Creditors* (Abingdon, Routledge-Cavendish, 2007) at 199–220.

3 Unreported, but see, 2014 WL 8106597.

4 Unreported, but see, 2014 WL 8106597 at [44].

[14.82]

The second and third elements referred to above (s 263(2)(b) and (c)) might not, because of the facts, have to be considered in some cases[1]. If the act complained of has already occurred (and had been authorised), the second element, ratification, is of no relevance. The third, dealing with authorisation, may be of no relevance unless the company submits that authorisation occurred before the act was committed or ratification has occurred since it had been committed[2]. Of course, if there is authorisation or ratification the director has not committed a wrong and the company cannot challenge what the director did. This is subject to the fact that some actions cannot be ratified under s 239 of the CA 2006, a matter discussed in detail in CHAPTER 16. It should be remembered in the context of s 263(2)(c)(ii), where a ratification has occurred, that a court[3]:

> "will need to determine whether the conditions for ratification are met and, in particular, where the purported ratification is by the general meeting, whether the shareholders were properly informed given that the wrongdoing directors are likely to conceal matters that might result in the shareholder vote going against them."

1 *Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Ch)* at [27].

[2] For a case where permission was not given against one respondent because of ratification, see *Brannigan v Style* [2016] EWHC 512 (Ch).

[3] A Keay and J Loughrey 'An Assessment of the Present State of Statutory Derivative Proceedings' in J Loughrey (ed) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar, 2013), at n 90. Also, see *Stainer v Lee* [2011] EWHC 2287 (Ch), *[2011] BCC 134* at [45]–[46].

[14.83]

In *Stainer v Lee* Roth J manifested concern that the shareholders in that case who voted by proxy in favour of the motion to ratify would not have actually given informed consent[1]. To enable a court to determine whether there is informed consent could lead to the submission of significant amounts of evidence and it could extend hearings substantially[2]. For a case where it was held that permission should be refused because the action complained of was either authorised beforehand or ratified ex post, see *Singh v Singh*[3].

[1] [2011] EWHC 2287 (Ch), [2011] BCC 134 at [46].

[2] J Tang 'Shareholder remedies: demise of the derivative claim?' (2012) 1 *UCL Journal of Law and Jurisprudence* 178 at 200.

[3] *[2013] EWHC 2138 (Ch)* at [39].

3 Other relevant factors

[14.84]

If an application is not knocked out by any of the factors in s 263(2) of the CA 2006, a court then considers six factors, which are a mixture of subjective and objective matters, and contained in s 263(3) and (4). These sub-sections do not prescribe a particular standard of proof that has to be satisfied but rather require consideration of a range of factors to reach an overall view[1]. These factors have to be weighed by the court[2]. Lord Goldsmith in the parliamentary debates expressed the view that all of the factors would be considered by the courts[3]. But one judgment has said that in any particular case not all of these factors may be relevant and need not be considered[4]. This is surprising given the fact that s 263(3) and (4) appear to make it mandatory for all of the factors to be taken into account. No factor is more important than another; it will all depend on the circumstances[5]. The factors that are enumerated in s 263(3) and (4) of the CA 2006 are not to be seen as exhaustive[6]. In *Franbar Holdings Ltd v Patel*[7] William Trower QC clearly accepted the fact that he could take into account factors not set out in the legislation[8]. The factors that are set out in s 263(3) and (4) and which must be taken into account are: whether the shareholder is acting in good faith; the importance which a person under a duty to promote the success of the company would attach to continuing the action; whether the wrong could be ratified or authorised; whether the company has decided not to bring a claim; the availability of an alternative remedy; and the views of the independent members of the company[9].

[1] *Stainer v Lee* [2010] EWHC 1539 (Ch), *[2011] BCC 134* at [29]; *Hughes v Weiss* [2012] EWHC 2363 (Ch) at [33]; *Brannigan v Style* [2016] EWHC 512 (Ch) at [44].

[2] *Brannigan v Style* [2016] EWHC 512 (Ch) at [66].

[3] Lords Grand Committee, 27 February 2006, Hansard HL vol 679, col GC26.

[4] *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch), *[2008] BCC 885* at [31].

[5] *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch), *[2008] BCC 885*.

[6] In *Bamford v Harvey* *[2012] EWHC 2858 (Ch)* at [29] Roth J said that he did not see anything against a court taking into account in a permission hearing the potential for the company itself to commence proceedings.

[7] *[2008] EWHC 1534 (Ch)*.

[8] [2008] EWHC 1534 (Ch) at [31].

[9] Companies Act 2006, s 263(3) and (4).

4 Good faith

[14.85]

The first factor that courts must consider (s 263(3)(a)) is the requirement of good faith. This is a criterion that is found in most statutory derivative claim schemes around the common law world[1], and it is used frequently in many areas of the law, not least of which is company law. The expression was discussed in CHAPTER 6 in the context of s 172.

[1] For example, Canada Business Corporations Act 1985, s 239(2)(b); Corporations Act 2001 (Australia), s 237(2)(b).

[14.86]

Professor Arad Reisberg points out that in Canada there have been a couple of approaches to the judicial view of good faith in the context of derivative claims. Courts have either taken an approach that involves considering each case on its own merits or seeing the good faith requirement as so serious that if there is a lack of good faith then leave would not be granted[1]. Certainly under the UK legislation the court must consider whether the applicant is acting in good faith and it would be entitled to refuse permission on the basis of a lack of good faith, but unlike the second approach in Canada it could only do so once it had considered all of the factors in s 263(3)–(4).

[1] A Reisberg *Derivative Actions and Corporate Governance* (Oxford, OUP, 2007) at 116 and referring to B R Cheffins 'Reforming the Derivative Action: The Canadian Experience and British Prospects' (1997) 2 CfiLR 227 at 249.

[14.87]

It has been held in Singapore[1] that the good faith element only relates to matters associated with the derivative proceedings, and does not have a wider scope, and while there is no case law on the subject in the UK this is probably the position here as well. Although after saying that, in one Scottish case the court took the view that the claimant was not acting in good faith as she was not trying to vindicate her rights as a member but was seeking to fund a continuation of a personal dispute between two company members and disallowed the application[2].

[1] *Fong Wai Lyn Carolyn v Airtrust Singapore Pte Ltd [2011] SGHC 88.*

[2] *Witter v QHSE Solutions Ltd* *[2016] SAC (Civ) 8* (Sheriff Appeal Court) at [27].

[14.88]

The presence of the good faith factor has been criticised as a rhetorical device that is 'replete with uncertainty in conception and highly unworkable in practice'[1]. Nevertheless, the courts are likely to derive some guidance from cases that have addressed the requirement under the common law process for derivative actions[2]. Besides these cases, Professor Jennifer Payne[3], writing well before the drafting of the CA 2006, suggested that cases applying the 'clean hands' doctrine[4] could also be treated as relevant to interpreting good faith. Under the old system in the UK if a shareholder did not have clean hands applicants would be denied permission to bring a derivative claim on the grounds that it would be inequitable to allow them to succeed in the action[5]. Payne was of the opinion that it is likely that the same approach will be employed under a statutory derivative action, on the basis that the requirement that the applicant was acting in good faith would mean that any bad faith that the applicant exhibited would disqualify him or her[6]. So far we do not appear to have any specific comments from judges in post-CA 2006 cases, except for the Scottish case of *Witter v QHSE Solutions Ltd*[7] which was mentioned in the previous paragraph and is mentioned again below. Of note is the fact that the courts have not disqualified applications under s 994 of the CA 2006 (or its precursor) on this basis[8], and they might feel that they should not discriminate between how the provisions are interpreted. On the other hand, it might be argued that with small family companies there could be some justification for a continuation of the former approach of the UK courts, and, unless the concept is interpreted too broadly, it could be a useful factor in ensuring unjustified claims are not brought. Payne, however, argues that the application of the clean hands doctrine is misconceived – the fact that an applicant has not acted with all propriety should not end up penalising the company and protecting those against whom proceedings should be brought – and she maintains that the case law which is relied upon as evidencing the application of the clean hands doctrine in derivative litigation can be explained on other grounds[9]. Nevertheless, in *Witter v QHSE Solutions Ltd*[10] the Sheriff Appeal Court in Scotland did refer to the fact that the applicant did not have clean hands and that this conclusion appeared to contribute to its decision that the applicant was not acting in good faith. This is, however, apparently the only case to do so up to now.

[1] A Reisberg 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) ECFR 69 at 101 and 103.

[2] *Portfolios of Distinction Ltd v Laird* [2004] EWHC 2071 (Ch), *[2005] BCC 216* at [30]–[31] and [63]; *Harley Street Capital Ltd v Tchigirinski (No 2) [2005] EWHC 247 (Ch), [2006] BCC 209* at [134]–[141].

[3] J Payne '"Clean Hands" in Derivative Actions' (2002) 61 CLJ 76.

[4] This is a well-established equitable concept and means that a person has acted, in the eyes of equity, in such a way that it is unjust that a claim brought at his or her behest is successful. See *Nurcombe v Nurcombe* [1985] 1 WLR 370 *(CA)*.

[5] For example, *Towers v African Tug Co* [1904] 1 Ch 558; *Nurcombe v Nurcombe* [1985] 1 WLR 370 *(CA)*.

[6] J Payne '"Clean Hands" in Derivative Actions' (2002) 61 CLJ 76 at 80.

[7] [2016] SAC (Civ) 8.

[8] For example, see *Re London School of Electronics Ltd* [1986] Ch 211.

[9] J Payne '"Clean Hands" in Derivative Actions' (2002) 61 CLJ 76 at 77, 80.

[10] [2016] SAC (Civ) 8 at [30].

[14.89]

The Canadian decision of *Abraham v Prosoccer*[1] makes it clear that if an applicant is only concerned about benefiting himself and not the interests of the company, then no leave will be granted[2]. If an applicant's self-interest coincides with the company's interests then the applicant would not be acting in bad faith in bringing the derivative proceedings[3].

1 *(1981) 119 DLR (3rd) 167*.

2 Also, see *Vedova v Garden House Inn Ltd (1985) 29 BLR 236* (Ont HC).

3 *Primex Investments Ltd v Northwest Sports Enterprises Ltd (1995) CanLII 717 (BCSC)*, *(1995) 13 BCLR (3d) 300 (SC)*.

[14.90]

It is clear in Australia (where good faith has been a critical issue in the obtaining of permission) and Canada that applicants will not be regarded as not acting in good faith merely because they stand to gain financially from a successful derivative action[1]. In fact in *Chahwan v Euphoric Pty Ltd*[2] the Court of Appeal of the New South Supreme Court said that if the applicant is a former member with nothing to gain directly by the success of the action the court will be very careful in examining the purpose behind the bringing of the application.

1 *Swansson v Pratt [2002] NSWSC 583*, *(2002) 42 ACSR 313*; *Magafas v Carantinos [2006] NSWSC 1459*; *Title v Harris (1990) 67 DLR (4th) 619 (Ont HCJ)*; *L & B Electric v Oickle (2006) 242 NSR (2d) 356*, *(2006) 267 DLR (4th) 263*, *(2006) 15 BLR (4th) 195* (Nova Scotia CA) at [63].

2 *[2008] NSWCA 52* at [70].

[14.91]

Some difficulty is caused by the decision in *Barrett v Duckett*[1]. In this case permission was denied by the court, in part because the shareholder had a collateral purpose in bringing the action, namely the litigation formed part of a personal vendetta. This is problematic because, as the judge at first instance noted, if ill-feeling disqualified a shareholder from bringing a derivative action, most derivative claims would be frustrated[2]. Such considerations have led the Australian courts to reject arguments that the good faith requirement will not be satisfied where the applicant is motivated by intense personal hostility or malice or where the applicant is a party to other legal proceedings that involve the persons who are to be the defendants in the derivative action[3]. As Palmer J stated in the New South Wales Supreme Court case of *Swansson v Pratt*[4], 'it is not the law that only a plaintiff who feels goodwill towards a defendant is entitled to sue', though he did agree that where the sole purpose of the action was a private vendetta, good faith would not be present[5]. However, distinguishing between an action motivated, partly by malice, and one motivated by a personal vendetta is surely a difficult task. In other jurisdictions, such as Singapore, courts have recognised that the applicant might well not have a happy relationship with the board, but that does not constitute a lack of good faith[6], and while the application was dismissed in *Seow Tiong Siew v Kwok, Fung & Winpac Paper Products Pte Ltd*[7], the court indicated that the fact that there was acrimony between the applicant and the board did not of itself mean that the applicant was acting other than in good faith. This approach has been supported in Canada, and it has actually been said that proof of 'bad blood' between the parties did not alone justify the conclusion that the applicant was acting in bad faith[8]. But, in *Singh v Singh*[9] HH Judge Hodge QC (sitting as a High Court judge) said that he would refuse permission on the basis of the claimant's personal animosity to the defendant (his brother) that arose out of a family dispute[10]. His Lordship did add that he felt that the true motivation behind the claim was to strike at the respondent rather than to promote the best interests of the company[11].

1 *[1995] BCC 362*.

2 *Barrett v Duckett [1995] BCC 362* at 372.

3 *Re The President's Club Pty Ltd [2012] QSC 364*.

4 *[2002] NSWSC 583*, *(2002) 42 ACSR 313*.

5 *[2002] NSWSC 583*, *(2002) 42 ACSR 313* at [41]. See, also, *Lewis v Nortex Pty Ltd (in liq.) [2006] NSWSC 768* at [3]–[6].

6 For instance, see *Teo Gek Luang v Ng Ai Tong [1999] 1 SLR 434* (Sing HC).

7 *[2000] 4 SLR 768*.

8 *Jabber v Ammache [2011] ABQB 504*.

9 *[2013] EWHC 2138 (Ch)*.

10 [2013] EWHC 2138 (Ch) at [44]. His Lordship did not simply rely on a lack of good faith, but would have refused permission on other grounds. Leave to appeal from the judgment was refused by Vos LJ: [2014] EWCA Civ 103 (and earlier, in a separate application before Kitchin LJ).

11 [2013] EWHC 2138 (Ch).

[14.92]

Perhaps an alternative interpretation of *Barrett v Duckett* is preferable. As the Australian courts have found, the issue of whether the shareholder is acting in good faith on the company's behalf is closely connected with whether the action is, in fact, in the interests of the company. Thus in *Barrett v Duckett* itself, the court's conclusion that the applicant was not litigating bona fide on the company's behalf was not based simply on evidence of her personal vendetta against the defendant. Rather, it was because she was conducting litigation in a manner that failed to advance or protect the company's interests. In particular she had failed to sue her daughter who was also involved in the wrongdoing, and she had initiated the litigation even though there was little hope of recovery for the company[1]. In the light of this, it is suggested that it is not necessary, nor is it desirable, for this case law to be interpreted in a manner that would deny permission to a shareholder to bring an action simply because there was a high level of personal hostility between the parties and this was the case in *Vinciquerra v MG Corrosion Consultants Pty Ltd*[2] where the court said that this was normal behaviour in litigation[3]. Rather, in such circumstances, the court should consider closely whether s 263(3)(b) is satisfied, that is whether a person under a duty to promote the success of the company would support the action. if this, and other, criteria are satisfied, then there appears no reason why litigation, which might otherwise be in the company's interests, should be prevented because it also serves the shareholder's private purposes[4]. When recommending the need for courts to consider the issue of good faith, the Law Commission also did not think that the fact that an applicant had some interest in the outcome of the derivative claim, would prevent him or her being granted leave[5]. On the other hand, where the shareholder's collateral purpose gives rise to a conflict of interest between the shareholder and the company, permission should be refused, either because the shareholder lacks good faith or because s 263(3)(b) is not satisfied. This approach would provide a barrier to actions pursued by a competitor of a company in order, for example, to gain access to confidential corporate information through the disclosure process, or to otherwise disrupt the company's business[6].

1 [1995] BCC 362 at 372–373. The court was also influenced by the fact that the applicant had failed to resort to her most obvious remedy being s 459 of the Companies Act 1985, and had only commenced the action after the defendant had attempted to put the company into liquidation: at 370. Furthermore, a preferable alternative remedy was available in the form of winding up: at 372. Reisberg also treats this case as one in which relief was denied as litigation was not in the company's interests: 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) ECFR 69 at 105. Also, see J Payne '"Clean Hands" in Derivative Actions' (2002) 61 CLJ 76 at 82.

2 [2010] FCA 763.

3 [2010] FCA 763 at [85].

4 See for example, the Australian case of *Lewis v Nortex Pty Ltd (in liq) [2006] NSWSC 768* at [3]–[6].

5 Law Commission *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at para 6.76.

6 See *Harley Street Capital Ltd v Tchigirinski (No 2) [2005] EWHC 2471 (Ch), [2006] BCC 209* at [68] and [5].

[14.93]

The case law under the statutory scheme seems to accept many of the points made by courts under the previous common law process or in other jurisdictions, particularly those made in Australia. The latest UK cases seem to indicate that an ulterior purpose will not automatically lead to a finding that good faith is absent, provided the claim can benefit the company. In *Franbar Holdings Ltd v Patel*[1], William Trower QC, while not commenting on the issue at hand in any detail stated that if a member had an ulterior motive in seeking permission, it might mean that the member was not acting in good faith, but he refrained from saying that having an ulterior motive precluded him or her from acting in good faith within the section under consideration[2]. The deputy judge rejected the allegations that there was a lack of good faith demonstrated by the applicant. In other cases an ulterior purpose has not been fatal[3] and this has included cases where a third party has funded the proceedings in order that he or she might benefit[4]. In *Iesini v Westrip Holdings Ltd*[5] Lewison J made it clear that if the claim is brought to benefit the company then the fact that the claimant will benefit from the claim will not lead to permission being refused[6]. HH Judge Behrens (sitting as a judge of the High Court) took a similar approach in *Parry v Bartlett*[7], as did HH Judge Keyser QC in *Hughes v Weiss*[8] when the latter said that a claim will not be regarded as being in bad faith merely because, besides the proper purposes of the litigation, the claimant is seeking to achieve a collateral purpose. The critical issue appears to be: is the claim in the interests of the company?[9] This means that the issue of good faith can be tied to s 263(3)(b), which is going to require, as we have seen when considering the criterion in s 263(2)(a), examination of such an issue. Therefore, if the proceedings could benefit the company it is less likely that the court will find that good faith is lacking. But, if the action could not be in the company's interests the contrary conclusion is more likely to be drawn by a court. All of this seems to be consistent, in general, with the approach of the courts in Australia and Canada, as mentioned earlier.

1 *[2008] EWHC 1534 (Ch)*.

2 [2008] EWHC 1534 (Ch) at [33].

3 At first instance in *Wishart* (*[2009] CSOH 20*; *2009 SLT 376* at [33]) it was remarked that it was unclear why a claim which could benefit the company should not proceed simply because the shareholder had other motives in bringing it.

4 See *Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch), [2010] BCC 420* at [114] and [120].

5 *[2009] EWHC 2526 (Ch), [2010] BCC 420*.

6 *Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch), [2010] BCC 420* at [121].

7 *[2011] EWHC 3146 (Ch), [2012] BCC 700* at [86].

8 *[2012] EWHC 2363 (Ch)* at [47].

9 This is perhaps similar to the criterion found in the legislation of other jurisdictions and requiring a claimant to demonstrate that he or she is acting in the best interests of the company. An example is Australia where the criterion of good faith and acting in the best interests of the company are frequently run together by the courts.

[14.94]

Besides the issue of benefit for the company, in *Stainer v Lee* Roth J indicates that if the applicant seeks and obtains the support of other minority shareholders before proceeding with the action, it will constitute strong evidence of good faith[1].

[1] [2010] EWHC 1539 (Ch), [2011] BCC 134 at [49].

[14.95]

If it is found that the applicant's action is influenced by a hope that he or she will be awarded an indemnity as far as costs is concerned, when one would not be granted if the action were brought under s 994 on the basis of unfair prejudice, this does not mean of itself that the shareholder/applicant is not acting in good faith[1].

[1] *Bhullar v Bhullar [2015] EWHC 1943 (Ch)* at [45].

[14.96]

As to what might constitute a failure to act in good faith, in *Wishart*[1] at first instance Lord Glennie acknowledged that there might be a lack of good faith where the applicant did not honestly believe that a cause of action existed or that it had a reasonable prospect of success. This accords broadly with what the Singaporean Court of Appeal said in *Ang Thiam Swee v Low Hian Chor*[2]. The court said that whether the applicant honestly believed that a good cause of action existed is the key factor in determining whether an applicant acted in good faith. Where there is a lack of honest belief, it is probable that the good faith factor is not likely to be important as permission would not be granted in any event on the basis that a director would not attach importance to continuing the action (under s 263(3)(b)). Just on this issue, the comments of Brereton J of the New South Wales Supreme Court in *Maher v Honeysett & Maher Electrical Contractors Pty Ltd*[3], are relevant. His Honour was of the view that he did not think that it was necessary for a court to find any particular means by which the applicant's belief that a good cause of action exists and that reasonable prospects of success could be established, because applicants rarely will know whether a good cause of action does exist; they will ordinarily rely on the advice of lawyers in this respect.

[1] *[2009] CSOH 20, 2009 SLT 376.*

[2] *[2013] SGCA 11.*

[3] *[2005] NSWSC 859* at [33].

[14.97]

It has been argued that when actions are pursued by a member who is in business as a competitor of the company, or where the claimant has purchased shares in the company after the wrong complained of has come to light and so the share price paid by the applicant reflects the company's loss, the courts should be more inclined to scrutinise the applicant's good faith, and be swifter to bar a claim on grounds of lack of good faith[1]. Allegations of a lack of good faith have been made in a number of cases, but thus far a lack of good faith has only been established in three cases[2], with most judges acknowledging that in the case before them the claimant/applicant was acting in good faith.

[1] A Keay and J Loughrey 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action Under the Companies Act 2006' (2008) 124 *LQR* 469 at 488 and 491.

2 *Stimpson v Southern Landlords Association [2009] EWHC 2072*, *[2010] BCC 387*; *Singh v Singh [2013] EWHC 2138 (Ch)*; *Witter v QHSE Solutions Ltd [2016] SAC (Civ) 8* (Sheriff Appeal Court). In the second of these cases the finding of lack of good faith was not the basis for the judge's decision. Judge Hodge QC based his decision on the fact that no director would take the action being sought to be taken by the applicant.

[14.98]

It is unclear whether the courts will interpret the good faith requirement in the CA 2006 to deny standing to a shareholder who falls within this category, but Payne's criticism of the unthinking application of 'clean hands' in these cases is convincing[1]. So, the UK courts, rather than following the common law on this point, might choose to follow the Australian approach, as adverted to earlier in this section of the chapter, where the courts have taken the view that they are not to examine whether the applicant has clean hands, nor are they to consider matters that are prejudicial to the credit of the applicant[2].

1 J Payne '"Clean Hands" in Derivative Actions' (2002) 61 CLJ 76 at 83–85. But note the decision in *Witter v QHSE Solutions Ltd [2016] SAC (Civ) 8* (Sheriff Appeal Court).

2 *Magafas v Carantinos [2006] NSWSC 1459* at [23].

[14.99]

The manner in which the Australian courts have considered the good faith requirement is helpful in other ways. Although they have allowed cross-examination of the applicant in order to determine whether he or she was acting in good faith[1], it seems that good faith can be established on quite low evidence[2], and in fact the indication from the New South Wales Supreme Court in *Braga v Braga Consolidated Pty Ltd*[3] was that the applicant will be regarded as acting in good faith, and the application will be allowed, if there is no reason to think, or an inference to be drawn, that the applicant is not acting in good faith[4].

1 *Talisman Technologies Inc v Qld Electronic Switching Pty Ltd [2001] QSC 324* at [24].

2 For example, see *Lakshman v Law Image Pty Ltd [2002] NSWSC 888* at [23].

3 *[2002] NSWSC 603* at [6].

4 This appears to have been the general approach of the Australian courts. For example, see *BL & GY International Co Ltd v Hypec Electronics Pty Ltd [2001] NSWSC 705*, *(2001) 164 FLR 268* at [89].

[14.100]

In Australia, in determining whether an applicant is or is not acting in good faith, it has been said that two questions have to be considered, namely: whether the applicant honestly believes that a good cause of action exists and has reasonable prospects of success; and, as we have seen, whether the applicant is seeking to act in a derivative capacity for such a collateral purpose as will amount to an abuse of process. Brereton J of the New South Wales Supreme Court in *Maher v Honeysett & Maher Electrical Contractors Pty Ltd*[1], approved of the two questions. But, the Court of Appeal of the New South Wales Supreme Court in a later case emphasised that acting in good faith should not be limited to consideration of the two questions which were posed above[2].

1 *[2005] NSWSC 859* at [33].

2 *Chahwan v Euphoric Pty Ltd [2008] NSWCA 52* at [82].

[14.101]

Again, in Australia, besides requiring the applicant to be acting in good faith, which is all about the subjective motivation of the applicant, applicants must also convince a court that the granting of leave is in the best interests of the company, an objective test[1]. Notwithstanding this difference in tests, it has been said that the outcome of the latter consideration might well assist in the determination of whether the applicant is acting in good faith[2]. So, it is not just a matter of the courts taking the assertion of applicants as to their belief as proof of good faith. For if no reasonable person in the circumstances would have held the belief that the applicant purports to hold, the applicant may well be disbelieved[3]. The courts take this view because in many cases the assertion of the applicant will be an unqualified opinion founded on hearsay and therefore has little weight or utility. Hence, the objective facts are more important[4]. It has been said that if there is no evidence to support the applicant's case the court will infer that there was no honest belief, and hence no good faith[5]. Thus far it does not appear that any UK court has permitted any inferences to be drawn from the conduct of applicants and general objective circumstances. It must be added that the Australian courts do not require applicants to depose to their belief, for all that is necessary is for the court to be satisfied concerning the applicant's good faith[6].

[1] *Talisman Technologies Inc v Qld Electronic Switching Pty Ltd [2001] QSC 324* at [31].

[2] *Talisman Technologies Inc v Qld Electronic Switching Pty Ltd [2001] QSC 324*.

[3] *Swansson v Pratt [2002] NSWSC 583*, *(2002) 42 ACSR 313* at [36]; *Magafas v Carantinos [2006] NSWSC 1459* at [19]; *Ragless v IPA Holdings Pty Ltd (in liq) [2008] SASC 90* at [28].

[4] *Magafas v Carantinos [2006] NSWSC 1459* at [19]. It is to be noted that The Singaporean Court of Appeal in *Ang Thiam Swee v Low Hian Chor [2013] SGCA 11* rejected the idea that the objective legal merits of a proposed action should be considered in determining the good faith of the applicant.

[5] *Carpenter v Pioneer Park Pty Ltd [2004] NSWSC 973*, *(2004) 186 FLR 104*, *(2004) 211 ALR 457* at [23].

[6] *South Johnstone Mill Ltd v Dennis and Scales [2007] FCA 1448* at [69].

[14.102]

Finally, the Australian case law indicates that the onus of proof on the applicant varies, depending on his or her standing. In *Swansson v Pratt*[1] Palmer J indicated that where the applicant is a current shareholder with more than a token shareholding and the derivative claim is seeking recovery of property that will increase the value of the applicant's shares, good faith will be relatively easy to establish. For example, in *Magafas v Carantinos*[2], where the applicant was a current shareholder in the company, holding 50 per cent of the shares, and the claim would enhance the value of the company's shares, the applicant was said to be acting in good faith[3]. The same goes for a director who is able to show a legitimate interest in ensuring that the company is well-managed and the action is to enhance the welfare of the company. A similar approach was taken at common law in the UK. In *Harley Street Capital v Tchigirinsky (No 2)*[4], for example, the court found that a corporate shareholder lacked bona fides when it held less than 0.28 per cent of shares, which it had bought after the alleged wrongdoing had been made public, and where the shareholder had failed to explain who its funders were, who was providing instructions to its lawyers and why it, and those who stood behind it, were interested in bringing the litigation at all[5]. Given the common approach of the Australian and UK courts (at common law) on this issue, it seems highly likely that, under the CA 2006, the courts will scrutinise the bona fides of a shareholder more carefully where the shareholder has no financial interest in the action either because, as in *Harley Street Capital*, the price at which the shareholder purchased the shares already reflected the market's response to the alleged wrongdoing or where, as in *Barrett v Duckett*, the company may be insolvent[6]. In such cases the courts are likely to require additional evidence as to bona fides.

[1] *[2002] NSWSC 583*, *(2002) 42 ACSR 313* at [38]. Also, see *Magafas v Carantinos [2006] NSWSC 1459* at [18].

[2] *[2006] NSWSC 1459* at [20].

[3] Also, see *First Edmonton Place Ltd v 315888 Alberta Ltd (1988) Alta LR (2d) 60* (Ala QB) in this regard.

[4] *[2005] EWHC 2471 (Ch)*, *[2006] BCC 209*.

[5] [2005] EWHC 2471 (Ch), [2006] BCC 209 at [135]–[137]; 229.

[6] *Barrett v Duckett [1995] 1 BCC 362* at 372. See, also, *Konamaneni v Rolls-Royce Industrial Power (India) Ltd [2002] 1 WLR 1269* at 1292.

[14.103]

In determining whether good faith exists, in Canada, where, as with Australia, good faith has been a critical issue, the courts will consider whether there was a genuine issue for trial in the derivative action and whether the proposed action was frivolous or vexatious[1]. But clearly, in each case good faith is ultimately a question of fact to be determined on all of the evidence and the particular circumstances of the case[2]. In Canada the judicial approach invoked is not to attempt to define good faith but rather to analyse each set of facts for the existence of bad faith on the part of the applicant. If bad faith is found, then the requirement of good faith has not been met[3]. The cases in this jurisdiction suggest that an applicant will be assisted in submitting that he or she is acting in good faith by tendering evidence of ongoing participation in corporate affairs[4], and the courts will not be inclined to find good faith if applicants have delayed in bringing proceedings[5], or have refused to look at information provided by those against whom proceedings are sought to be brought[6].

[1] *First Edmonton Place Ltd v 315888 Alberta Ltd (1988) Alta LR (2d) 60 (Alta QB)*; *Winfield v Daniel (2004) 352 AR 82*, *(2004) ABQB 40 (Alta QB)*; *Re Marc-Jay Investments Inc and Levy (1974) 50 DLR (3d) 45 (Ont HC)*; *L & B Electric v Oickle (2006) 242 NSR (2d) 356*, *(2006), 267 DLR (4th) 263*, *(2006) 15 BLR (4th) 195* (Nova Scotia CA) at [64].

[2] *Discovery Enterprises Inc v Ebco Industries Ltd (1998) CanLII 7049 (BCCA)*, *(1998) 50 BCLR (3d) 195 (BCCA)*; *L & B Electric v Oickle (2006) 242 NSR (2d) 356*, *(2006), 267 DLR (4th) 263*, *(2006) 15 BLR (4th) 195* (Nova Scotia CA) at [59].

[3] *Winfield v Daniel (2004) 352 AR 82*; *L & B Electric v Oickle (2006) 242 NSR (2d) 356*, *(2006), 267 DLR (4th) 263*, *(2006) 15 BLR (4th) 195* (Nova Scotia CA) at [60].

[4] *Appotive v Computrex Centres Ltd (1981) 16 BLR 133 (BCSC)*; *Re Besenski (1981) 15 Sask R 182* (Sask QB); *Johnson v Meyer (1987) 62 Sask R 34* (Sask QB).

[5] *Churchill Pulpmill Ltd v Manitoba [1977] 6 WWR 109 (Man CA)*; *LeDrew v LeDrew Lumber Co (1988) 223 APR 71*.

[6] *Benarroch v City Resources (Can) Ltd (1991) 54 BCLR (2d) 373 (BCCA)*.

[14.104]

The case law[1] does place the burden of proving lack of good faith upon the defendants and it has been said that an allegation of bad faith would require 'precise averments and cogent evidence'[2]. This should deter speculative allegations of lack of good faith and so reduce the length of the proceedings.

[1] For instance, *Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Ch)*, *[2008] BCC 885* at [33]–[34]; *Wishart [2009] CSOH 20*; *2009 SLT 376* at [33].

[2] *Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Ch)*, *[2008] BCC 885* at [33]–[34].

5 Importance to a person acting in accordance with s 172

[14.105]

This factor is set out in s 263(3)(b). The need to consider how a person would act in pursuing the duty found in s 172 was adverted to earlier. The criteria in s 263(2)(a) and s 263(3)(b) involve the same matters, but they undertake different roles. Also, while an applicant might be able to hurdle the s 263(2)(a) requirement as far as the s 172 duty is concerned, it would appear that he or she will encounter more difficulty when the duty is considered by the judge in terms of the s 263(3) factors[1]. In *Franbar Holdings Ltd v Patel*[2] William Trower QC said that the criterion in the latter provision is a difficult one to assess[3]. It would appear that while the use of it in s 263(2)(a) is to permit courts to refuse permission for claims that are not substantial, the use of it in s 263(3)(b) involves judges looking more closely at the kind of factors that would really determine where a director would indeed pursue the claim. Also, while in the former case it is considered on its own and on the basis that a court would refuse permission if the case was not one that a director would take on, in the latter case the criterion is assessed in conjunction with the other criteria that are adumbrated in s 263(3). William Trower QC indicated that a director who has to decide whether to take legal proceedings, and who was acting in accordance with s 172, would have concern for a number of considerations, namely: prospects of success; the likelihood of the company being able to recover property or money if successful; how disruptive it would be to the company's business in prosecuting proceedings; and any damage to the reputation and business of the company if proceedings turned out to be unsuccessful[4]. The appeal court in *Wishart*[5] added other matters, such as: the amount at stake[6]; and the prospects of getting a satisfactory result without litigation. These are probably wider in scope than those that the deputy judge laid down for consideration in *Franbar Holdings Ltd v Patel* when considering this criterion in the context of s 263(2)(a). This criterion has, in the majority of cases decided hitherto, consumed much of the court's time in arriving at its decision.

[1] See A Keay 'Applications to Continue Derivative Proceedings on Behalf of Companies and the Hypothetical Director Test' (2015) 34 *Civil Justice Quarterly* 346.

[2] *[2008] EWHC 1534 (Ch)*.

[3] [2008] EWHC 1534 (Ch) at [35].

[4] [2008] EWHC 1534 (Ch) at [36].

[5] *[2009] CSIH 65*, *2009 SLT 812* at [37].

[6] Also mentioned in *Kiani v Cooper [2010] EWHC 577 (Ch)*, *[2010] BCC 463* at [44]. But in *Stainer v Lee [2010] EWHC 1539 (Ch)*, *[2011] BCC 134* at [29] Roth J appeared to downplay the fact that the amount of the recovery might be small where the applicant's case was strong as he felt that such a claim might stand a good chance of provoking an early settlement or leading to summary judgment.

[14.106]

A difficulty that might exist for a member wanting to obtain permission is that in *Franbar Holdings* the deputy judge said that he felt that the applicant needed to do more work in formulating a claim for breaches[1]. Yet this comment was made after the deputy judge had said earlier in his judgment that 'a director will often be in the position of having to make what is no more than a partially informed decision on continuation without any very clear idea of how the proceedings might turn out'[2]. The court in *Wishart* agreed with this latter view as it said that directors ordinarily have to take decisions concerning whether litigation should or should not be commenced 'on the basis of only partial information, without undertaking a lengthy investigation of the merits of the proposed case'[3]. These comments appear to produce some uncertainty and it makes it difficult for an

applicant to know how far he or she is required to develop a case before seeking permission. Clearly any case put before a court must indicate an arguable case in the applicant's favour[4], but, as the respective courts above have indicated, when considering the factor in s 263(3)(b), they must take into account the fact that hypothetical directors would not necessarily expect an 'iron-clad' case before instituting proceedings. If the courts expect shareholders to make an application only when they have a substantial case then the ambit of the derivative claim will be severely circumscribed, particularly since much of the information needed to frame a detailed case will be in the hands of the directors, and will not be accessible to the shareholders until much later in the proceedings, perhaps at the disclosure stage of litigation.

1 [2008] EWHC 1534 (Ch), [2008] BCC 885 at [54].

2 [2008] EWHC 1534 (Ch), [2008] BCC 885 at [36].

3 [2009] CSIH 65, 2009 SLT 812 at [37].

4 [2009] CSIH 65, 2009 SLT 812 at [38].

[14.107]

This criteria is discussed further under the later heading 'Best interests of the company'.

6 Likelihood of authorisation or ratification

[14.108]

According to s 263(3)(c) where the cause of action is the consequence of an act or omission yet to occur, the court must take account of the likelihood of it being authorised by the company before it occurs or ratified after it occurs[1]. The following paragraph (s 263(3)(d)) provides that if the act or omission on which the cause of action is founded has occurred the court must consider the likelihood of it being ratified by the company. It is quite possible that the courts might, in taking into account this latter criterion, have to examine whether the act could be ratified legally or practically. Ratification is considered in detail in CHAPTER 16. The court has the power, under s 261(4), to adjourn a permission application, and it might do so and contemporaneously order a meeting of the members to see if a resolution to ratify succeeds. This criterion constitutes a 'tipping of the hat' to the age-old majority rule that has applied in company law for many years. Parliament does not want to be seen to be intervening in the democratic process in companies.

1 For greater discussion of this issue, see A Keay and J Loughrey 'An assessment of the present state of statutory derivative proceedings' in J Loughrey (ed) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar, 2013) at 202–207.

[14.109]

While the UK legislation talks about the likelihood of ratification, two other jurisdictions that have legislation closest to the UK's do not. In Canada ratification is not mentioned as a criterion to be considered in relation to obtaining leave to bring a derivative claim[1]. In Australia s 239(1)(a) of the Corporations Act 2001 explicitly states that ratification does not prevent a person from bringing proceedings with leave or for applying for leave; but the next subsection does state that if ratification has occurred the court *may* take that into account in deciding what order to make[2].

1 Canada Business Corporations Act 1985, s 239.

2 This issue is discussed in A Keay 'Assessing and Rethinking the Statutory Scheme for Derivative Actions Under the Companies Act 2006' (2016) 16 *Journal of Corporate Law Studies* 39.

[14.110]

We must not forget that the ratification rules have been tightened somewhat by s 239 of the CA 2006, and this might mean that courts will not be so ready to assume, as they once might have been, that an act will be ratified. A court would need to consider in determining whether the action complained of would be ratified the nature of the votes of the shareholders, and who can be regarded as connected to the respondent/director, because connected persons would not be eligible to vote[1]. There might be some difficulty in convincing the court that a person is connected. In *Franbar Holdings Ltd v Patel*[2] William Trower QC considered this issue (an issue dealt with in more detail in CHAPTER 16). It was indicated to the court that it was likely that the action complained of would be ratified. In deciding whether to exercise its discretion in favour of granting leave the court therefore had to determine whether such ratification would be effective. The deputy judge was of the view that it was no more than a possibility that the alleged breaches of duty in relation to which the member wished to bring proceedings could be effectively ratified[3].

1 See s 239(3).

2 *[2008] EWHC 1534 (Ch)*.

3 [2008] EWHC 1534 (Ch) at [47].

[14.111]

Brannigan v Style[1] is an instance of a court rejecting an application to continue a derivative action against directors because of ratification. Here an application against one of four directors named as respondents was denied by Aplin J as the director's conduct had been validly ratified by the general meeting.

1 *[2016] EWHC 512 (Ch)*.

[14.112]

It would seem that in the context of ratification the concept of wrongdoer control has made a re-appearance[1]. In *Parry v Bartlett* HH Judge Behrens (sitting as a High Court judge) found that the conduct complained of by the claimant was not ratifiable because the company was subject to wrongdoer control[2]. In *Bridge v Harvey*[3] HH Judge Hodge QC (sitting as a High Court judge) said that the absence of wrongdoer control in the company, while not an absolute bar, was a relevant factor to be taken into consideration. This approach seemed to echo the view espoused in *Stimpson v Southern Landlords Association*[4] by HH Judge Pelling QC (sitting as a High Court judge). However, the view just stated contradicts the approach adopted in Scotland. The Inner House of the Court of Session in both *Wishart*[5] and *ICU (Europe) Ltd v Ibrahim*[6] indicated that the new legislation was intended to get rid of the uncertainties that existed at common law with the exceptions to the rule in *Foss v Harbottle*, and 'wrongdoer control' was identified as being amongst those uncertainties. In *Bamford v Harvey*[7] Roth J adverted to the apparent difference between the English and Scottish courts on this matter and said that ideally there should be consistency, but at present there may well be inconsistency. Perhaps consideration of wrongdoer control is necessary as a judge needs to get an idea of the way that persons are likely to vote. But it might be unhelpful to express it in this way. Potentially it could raise the issue of what amounts to wrongdoer control of the general meeting, an issue which gives rise to substantial difficulties, including the matter of ascertaining whether particular shareholders are connected or not. While it may be easy to show in small private companies that the alleged wrongdoers control the general meeting, in larger companies it would be difficult to identify on whose behalf shares are held[8]. Overall, it is submitted that

the approach of the Scottish courts is to be preferred on the issue, namely no decision should be made concerning permission to continue or commence a derivative action on the basis of wrongdoer control.

[1] For a discussion of wrongdoer control, see A Keay and J Loughrey 'An assessment of the present state of statutory derivative proceedings' in J Loughrey (ed) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar, 2013) at 217; J Armour, 'Derivative actions: a framework for decisions' (2019) 135 LQR 412 at 423–426.

[2] [2011] EWHC 3146 (Ch), [2012] BCC 700 at [81].

[3] *[2015] EWHC 2121 (Ch)* at [25].

[4] *[2009] EWHC 2072*, *[2010] BCC 387* at [46].

[5] *[2009] CSIH 65*, *2009 SLT 812*.

[6] *[2016] CSIH 62*.

[7] *[2012] EWHC 2858 (Ch)*.

[8] Law Commission, *Shareholder Remedies: Consultation Paper* (Law Com, Consultation Paper No 142) (London, Stationery Office, 1997) at para 4.13.

[14.113]

There have always been two views as to when ratification would be effective or not, one turning on the nature of the wrong, and the other deeming an action not to be ratifiable because the wrongdoers were seeking to ratify their own default in order to oppress the minority[1]. The predominance of case law and academic commentary has been in favour of the former view[2]. What Judge Behrens appeared to do in *Parry v Bartlett* was to employ the latter view. It has been submitted that it might be preferable for courts to focus on the former view and to categorise the alleged wrongs committed in order to ascertain if they are capable of being ratified[3].

[1] A Keay and J Loughrey 'An Assessment of the Present State of Statutory Derivative Proceedings' in J Loghrey (ed) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar, 2013) at 205.

[2] K Wedderburn 'Shareholders Rights and the Rule in *Foss v Harbottle*' *[1958] CLJ 93* at 96; J Payne 'A Re-Examination of Ratification' [1999] CLJ 604 at 614; H C Hirt 'Ratification of Breaches of Directors' Duties: the Implications of the Reform Proposal Regarding the Availability of Derivative Actions' (2004) 25 *Company Lawyer* 197 at 203.

[3] A Keay and J Loughrey 'An Assessment of the Present State of Statutory Derivative Proceedings' in J Loughrey (ed) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar, 2013) at 206.

7 The company has decided not to pursue the claim

[14.114]

Section 263(3)(e) of the CA 2006 requires the court to take into account whether the company has decided not to pursue the claim. The fact that a company has decided not to pursue a claim could well be an important factor in the court's decision whether or not to give permission. But if the company has made this decision based on reasons that the courts do not find convincing or appropriate this might make the courts more ready to grant permission. Courts, it would appear, would need to investigate the circumstances and independence of decisions that have been made not to take action[1].

1 A Reisberg *Derivative Actions and Corporate Governance* (OUP, 2007) at 156.

8 Alternative remedy

[14.115]

The CA 2006 in s 263(3)(f) provides that the court must consider whether the act of omission in respect of which the derivative claim is brought gives rise to a cause of action that the member could pursue in his or her own right[1]. This was something that was also to be considered at common law. But, while the CA 2006 provides that the court must consider whether there is an alternative cause of action that the member could pursue in his or her own right[2], the common law was broader, and all remedies were taken into account, including alternative avenues of redress for the company itself[3]. An example of refusing permission where an alternative remedy was available occurred in *Cooke v Cooke*[4] where an application under the precursor of s 994 of the CA 2006 was viewed as being more appropriate. In *Mumbray v Lapper*[5] the judge said that whether an alternative remedy is available or not was a factor, and it may well be an extremely important factor; but it was not an absolute bar to permission being granted[6].

1 There has been some lack of clarity regarding the relevance of an alternative remedy: compare *Konamaneni v Rolls-Royce Industrial Power (India) Ltd [2002] 1 WLR 1269* at 1279, where Lawrence Collins J stated that it was not an independent consideration, with *Mumbray v Lapper [2005] EWHC 1152 (Ch), [2005] BCC 990* at [5] in which Robert Reid QC thought it could be an extremely important factor for the court to take into account.

2 Companies Act 2006, s 263(3)(f).

3 *Barrett v Duckett [1995] BCC 362* at 372.

4 *[1997] 2 BCLC 28*.

5 *[2005] EWHC 1152 (Ch), [2005] BCC 990*.

6 [2005] EWHC 1152 (Ch), [2005] BCC 990 at [5].

[14.116]

In *Mumbray v Lapper* winding up on the just and equitable ground[1], or a s 459 (now s 994) petition[2] were found to be preferable to a derivative action, and permission was refused. The petitioner had participated in the wrongdoing, the company was deadlocked and no longer trading and, if liquidation was pursued, the liquidator could determine whether to take proceedings in the company's name against the alleged wrongdoers[3]. It does not seem though that the fact that a quasi-partnership is deadlocked can, alone, lead to permission being refused on the basis that, for example, winding up is preferable. There are cases in which permission has been granted despite the fact that the only two members of a company that was a quasi-partnership can no longer work together[4]. In *Mumbray v Lapper*, however, it was significant that the applicant was also an alleged wrongdoer. It seems that the courts were more likely, at common law, to prefer alternative remedies where the applicant lacked good faith[5].

1 Under the Insolvency Act 1986, s 122(1)(g).

2 Under the Companies Act 1985, and now superseded by s 994 of the Companies Act 2006.

[3] [2005] EWHC 1152 (Ch), [2005] BCC 990 at [23]; contrast the Australian case of *Kandt Stening Group Pty Ltd v Stening [2006] NSWSC 307* at [33] (company dormant and had no assets save what was under dispute in the litigation, and leave was granted).

[4] *Halle v Trax BW Ltd [2000] BCC 1020*; *Qayoumi v Oakhouse Property Holdings Plc* [2002] EWHC 2547 (Ch), [2003] 1 BCLC 352; *Fansa v Alsibahie* [2005] EWHC 271 (Ch), [2005] All ER (D) 80 (Jan). With the exception of the company in *Halle v Trax*, however, it is not clear that the companies in question were deadlocked.

[5] *Barrett v Duckett [1995] BCC 362*; *Portfolios of Distinction Ltd v Laird* [2004] EWHC 2071 (Ch), *[2005] BCC 216*.

[14.117]

In another case where permission was refused (under the former law), *Jafari-Fini v Skillglass Ltd*[1], the refusal was based on the fact that the shareholder had a personal cause of action arising out of the same facts as gave rise to the derivative claim and, if the shareholder succeeded in his personal claim he would retake control of the company and could then cause it to bring proceedings, whereas if he failed the company's claim also evaporated[2]. While this approach could have delayed any recovery to which the company was entitled, in this case the only asset that could have been recovered was worthless[3]. In the circumstances, therefore, the company had nothing to gain from litigation being brought on its behalf and it was not in its interests for permission to be given[4]. This emphasises the fact that the derivative claim procedure is all about what is best for the company and not what is best for an individual shareholder.

[1] *[2005] EWCA Civ 356, [2005] BCC 842*.

[2] [2005] EWCA Civ 356, [2005] BCC 842 at [47] and [52].

[3] [2005] EWCA Civ 356, [2005] BCC 842 at [25] and [52].

[4] The Australian courts would probably adopt a similar approach. See, for example, *Swansson v Pratt [2002] NSWSC 583* at [63]–[69]; *Promaco Conventions Pty Ltd v Dedline Printing Pty Ltd [2007] FCA 586* at [46]–[52].

[14.118]

A decision, *Airey v Cordell*[1], given shortly before the introduction of the new scheme, importantly gave a broad interpretation to the concept of an alternative remedy. The court held that it included a settlement of the dispute which adequately protected the shareholder's interests[2]. The problem with this is that it risks sanctioning 'green-mailing', the practice whereby shareholders bring derivative actions to pressurise company management to buy their shares at above the market price. It could deprive independent shareholders of a solvent company, and creditors of an insolvent one, of the benefit of recovery on the company's behalf. Again, if a shareholder were minded to accept a share purchase in settlement of the claim, the appropriate course would be to refuse permission on the basis that s 994 of the CA 2006 provided a preferable remedy. On the other hand, given the facts of *Airey v Cordell* itself, the approach may be defensible. The company was closely-held and solvent, so that the company's interests were comprised of the interests of the disputing shareholders, and the shareholder wished to remain in the company, and protect his interest in it[3].

[1] *[2006] EWHC 2728 (Ch), [2007] Bus L R 391*.

[2] [2006] EWHC 2728 (Ch), [2007] Bus L R 391 at [84]–[86].

[3] *Airey v Cordell [2006] EWHC 2728 (Ch), [2007] Bus L R 391* at [48] and [84].

[14.119]

In *Franbar Holdings Ltd v Patel*[1] William Trower QC, who was dealing with the new law, was of the view that reference to an alternate cause of action should be seen as broad, and provided that another remedy was based on the same act or omission on which the derivative claim would be based, it would come within s 263(3)(f) of the CA 2006[2]. According to the deputy judge an alternate cause of action to be within the paragraph does not have to be one that is against the same people who would be the respondents in a derivative claim[3]. So, if the acts involved would enable the bringing of an action under s 994 for unfair prejudice, and in most cases this is the basis on which an alternate remedy will be available or at least that possibility will be considered by the court, the court will take this into account in deciding whether or not to grant permission to commence a derivative claim. In many cases there will be overlaps between a derivative claim and a claim under s 994 of the Act[4]. In *Franbar Holdings*, William Trower QC attached substantial weight to the fact that he thought that a s 994 action could bring the relief that the member sought and, thus taking into account other factors, he refused to grant permission to continue a derivative claim[5]. Earlier, Floyd J in *Mission Capital plc v Sinclair*[6] had taken the same view[7]. But in the more recent decision in *Bhullar v Bhullar*[8], which involved a double derivative action that was not governed by the statutory scheme but by the common law, Morgan J did not deny the application for the continuation of a derivative claim when there was substantial argument put to support the view that a more appropriate way for the applicant to proceed was via a s 994 petition. The reasons why his Lordship appeared to take this view were that the issues in the derivative claim were relatively narrow and self-contained whereas the issues in a s 994 claim would be significantly wider and s 994 would be slow and expensive if the claim went all the way to a trial[9]. Also the judge might have been influenced by the applicant's argument that the derivative claim issues should be addressed first as that might precipitate the basis for a settlement of the overall dispute between the respective parties[10]. More importantly, in another case, *Hook v Summer*[11], which did deal with the statutory scheme, the judge granted the application for the continuation of a derivative action even though there was evidence to suggest that the applicant could bring unfair prejudice proceedings. The court was influenced by the fact that the reason that the applicant did not present a s 994 petition was that he did not wish to be bought out and with successful s 994 petitions it was quite likely that a court might order that his shares be purchased. The judge, HH Judge Cook (sitting as a judge of the High Court) said that the applicant cannot be said to have acted unreasonably in preferring to bring a derivative action instead of instituting unfair prejudice proceedings[12].

1 *[2008] EWHC 1534 (Ch)*.

2 [2008] EWHC 1534 (Ch) at [50].

3 [2008] EWHC 1534 (Ch).

4 For a discussion of this overlap, see, B Hannigan 'Drawing Boundaries Between Derivative Claims and Unfairly Prejudicial Petitions' (2009) 6 JBL 606. In *Langley Ward Ltd v Trevor* *[2011] EWHC 1893 (Ch)*, the court held that a winding up petition on just and equitable grounds would have been a more suitable remedy than a derivative claim and permission would have been refused on this basis had it not already been refused on other grounds.

5 [2008] EWHC 1534 (Ch) at [54].

6 *[2008] EWHC 1339 (Ch)*.

7 It is to be noted that David Donaldson QC in *Langley Ward Ltd v Trevor* *[2011] EWHC 1893 (Ch)* at [13], felt that a petition under s 994 did not fall easily within the expression 'cause of action' but he seemed to accept that s 994 could be an alternative remedy within the criterion.

8 *[2015] EWHC 1943 (Ch)*.

9 [2015] EWHC 1943 (Ch) at [44].

10 [2015] EWHC 1943 (Ch) at [43], [44].

11 [2015] EWHC 3820 (Ch).

[12] [2015] EWHC 3820 (Ch) at [135].

[14.120]

As at common law, the fact that a court takes the view that an alternative remedy is possible under the statute, it alone should not necessarily mean that permission should be refused. But the decisions in *Franbar Holdings*[1], *Iesini*[2] and *Kleanthous v Paphitis*[3] seem to make the availability of an alternative remedy a compelling reason for withholding permission[4]. In *Kleanthous* Newey J considered that it was a 'powerful reason' to refuse permission[5]. This is notwithstanding that in *Iesini*, Lewison J said that the existence of an alternative remedy was not an absolute bar to permission being granted[6]. *Kiani v Cooper*[7] is an instance of a case where it was held that this factor was only one of several to consider and in that case the other factors outweighed it and permission was granted. In *Phillips v Fryer*[8] permission was granted even though the claimant had already presented a s 994 petition which involved relying on matters that overlapped with the derivative claim. The judge, Nicholas Strauss QC (sitting as a deputy judge of the High Court), did this because the derivative claim could be dealt with much more swiftly than the s 994 petition which was set down for six days, and also the derivative claim was apparently strong. HH Judge Barker QC (sitting as a High Court judge) in *Montgold Capital LLP v Iliska*[9] also adopted a more liberal position than judges in some earlier decisions. His Lordship said that a derivative action could run alongside an action brought on the basis of unfair prejudice[10]. He opined that the allegations made by the claimant in this case were best suited to being considered in a derivative claim[11].

[1] *[2008] EWHC 1534 (Ch)*, *[2008] BCC 885* at [30].

[2] *[2009] EWHC 2526*, *[2010] BCC 420* at [86].

[3] *[2011] EWHC 2287 (Ch)* at [81].

[4] See the discussion in A Keay 'Assessing and Rethinking the Statutory Scheme for Derivative Actions under the Companies Act 2006' (2016) 16 *Journal of Corporate Law Studies* 39.

[5] A Keay 'Assessing and Rethinking the Statutory Scheme for Derivative Actions under the Companies Act 2006' (2016) 16 *Journal of Corporate Law Studies* 39.

[6] [2009] EWHC 2526, [2010] BCC 420 at [123].

[7] *[2010[EWHC 577 (Ch)*, *[2010] BCC 463*.

[8] *[2011] EWHC 1611 (Ch)*.

[9] *[2018] EWHC 2982 (Ch)*.

[10] [2018] EWHC 2982 (Ch) at [40].

[11] [2018] EWHC 2982 (Ch) at [40].

[14.121]

A court might take the view that if it sanctioned a derivative action where a member has also initiated s 994 proceedings, it would be seen as approving of 'green-mailing'. Also, a court could withhold permission on the basis that when hearing the s 994 petition it is able to make an order that the company institute proceedings against the directors or others[1]. The problem which this view would create for the applicant is that there will

be a long delay before the hearing of a claim against a director or others for damaging the company is actually heard. The applicant must wait for the s 994 petition to be heard, hope that the court orders the company to bring proceedings against the wrongdoer(s) and then wait for those proceedings to come to trial. The uncertainties and time delay inherent in this process could well see the wrongdoers escaping, for a number of reasons, not least being the fact that the member runs out of funds and/or energy.

1 See s 996(2)(c).

[14.122]

The court may also take the view, as in *Kleanthous v Paphitis*[1], that the shareholder is bringing a derivative action solely to obtain the benefit of a costs indemnity order, in which case the s 994 petition (where the shareholder bears his or her own costs until he or she succeeds and a court awards the shareholder costs[2]) would be more appropriate[3]. Yet in *Bhullar v Bhullar*[4] the deputy judge did not see a problem with the fact that the bringing of the applicant's derivative action was influenced by a hope that he would be awarded an indemnity as far as costs is concerned, when one would not be granted if his action were brought under s 994 on the basis of unfair prejudice. It must not be forgotten that a costs order in the shareholder's favour when permission is granted is discretionary[5]. Therefore, concern over costs need not deter the courts from granting permission if other factors point towards the derivative claim being the appropriate remedy. What is important is the nature of the wrong alleged and the remedy sought[6]. In *Kleanthous* the wrong alleged was the diversion of a corporate opportunity[7]. This is misconduct which would properly form the basis of a derivative claim and would be most appropriately addressed by granting a remedy to the company. A further consideration is that directing these types of claims towards the unfair prejudice remedy and the grant of a personal remedy to the shareholder may prejudice the interests of creditors if the company is of doubtful solvency or in financial difficulties[8].

1 *[2011] EWHC 2287 (Ch)*.

2 But even if this occurs all of the shareholders will not usually be paid by the respondent.

3 [2011] EWHC 2287 at [81].

4 *[2015] EWHC 1943 (Ch)* at [45].

5 See the comments of HH Judge Keyser QC in *Hughes v Weiss* *[2012] EWHC 2363 (Ch)* at [55].

6 *Stainer v Lee* [2010] EWHC 1539 (Ch), *[2011] BCC 134* at [51] and citing Millett J *In Re Charnley Davies Ltd (No 2) [1990] BCC 605* at 625.

7 [2011] EWHC 2287 (Ch) at [32].

8 B Hannigan 'Drawing Boundaries Between Derivative Claims and Unfairly Prejudicial Petitions' (2009) 6 *Journal of Business Law* 606 at 617–620. Hannigan argues that this problem could be addressed within the context of a s 994 petition by the court ordering both a buy out of the petitioner's shares and for the wrongdoers to compensate the company.

[14.123]

It is likely that the usual alternative remedy that a court might find available to an applicant, as foreshadowed by our discussion thus far, is a s 994 petition. But in *Langley Ward Ltd v Trevor*[1] David Donaldson QC took the view that a petition to wind up, probably on the just and equitable ground (s 122(1)(g) of the Insolvency Act 1986), was a more appropriate action for the applicant/claimant to take[2].

1 *[2011] EWHC 1893 (Ch)*.

2 In *Singh v Singh* (*[2013] EWHC 2138* at [45] (Ch)), HH Judge Hodge QC was of the opinion that either a s 994 petition or a petition on the just and equitable ground would constitute alternative remedies to a derivative claim.

[14.124]

While *Iesini* and *Kleanthous v Paphitis* regarded the availability of an alternative remedy as a compelling reason for refusing permission, other courts have not done so. The appeal court in *Wishart* did not consider it to be grounds for refusing permission because proceedings under s 994 would constitute an indirect means of achieving what could be achieved directly through the use of derivative action[1]. HH Judge Behrens reached a similar conclusion in *Parry v Bartlett*[2], and he made the point that this criterion was only a factor that that had to be taken into account and did not operate as a complete bar to a derivative claim[3], a view clearly taken at common law. Admittedly in these two latter cases the argument for the bringing of derivative actions was probably stronger overall than any or, at least, most of the other cases heard thus far under the new scheme.

1 *[2009] CSIH 65*, *2009 SLT 812* at [46].

2 *[2011] EWHC 3146 (Ch)*, *[2012] BCC 700* at [88]–[92].

3 [2011] EWHC 3146 (Ch), [2012] BCC 700 at [89], [91].

[14.125]

What is happening is that there are relatively few derivative actions being commenced and a proliferation of unfair prejudice proceedings[1]. The way that the jurisprudence has developed on this subject has led to a problem for litigants: on which basis should an action be initiated – a derivative basis or under s 994? The reason for this is that there has been a failure to distinguish between the wrongs that should be remedied by a derivative action and those by an unfair prejudice action, and this is due to the fact that the courts have not listed the personal rights of shareholders that will be protected by s 994[2]. This is a major issue and is outside the scope of this chapter and involves broader issues, so it is not intended to deal with it in any depth, but it has been discussed elsewhere[3].

1 See, A Keay 'Assessing and Rethinking the Statutory Scheme for Derivative Actions under the Companies Act 2006' (2016) 16 *Journal of Corporate Law Studies* 39.

2 J Poole and P Roberts 'Shareholder Remedies – Corporate Wrongs and the Derivative Action' [1999] JBL 99 at 113–114.

3 It is discussed in J Payne 'Sections 459–461 Companies Act 1985 in Flux: The Future of Shareholder Protection' (2005) 64 CLJ 647; R Cheung 'Corporate Wrongs Litigated in the Context of Unfair Prejudice Claims: Reforming the Unfair Prejudice Remedy for the Redress of Corporate Wrongs' (2008) 29 *Company Lawyer* 98; B Hannigan 'Drawing Boundaries Between Derivative Claims and Unfairly Prejudicial Petitions' [2009] JBL 606; A Gray 'The Statutory Derivative Claim: An Outmoded Superfluousness?' (2012) 33 *Company Lawyer* 295; A Keay 'Assessing and Rethinking the Statutory Scheme for Derivative Actions under the Companies Act 2006' (2016) 16 *Journal of Corporate Law Studies* 39.

[14.126]

In dealing with whether a derivative action or an unfair prejudice was the correct way to proceed, Millett J (as he then was) said in *Re Charnley Davies Ltd (No 2)*[1] that the same facts could found either action, but the nature of the complaint and the appropriate relief will be different. His Lordship went on to say that if a shareholder's essential complaint was of the unlawfulness of a respondent's conduct, with the result that any order made would be for restitution, then a derivative action would have been appropriate and not an unfair prejudice petition. But if a respondent's unlawful conduct is alleged to be evidence of the manner in which he or

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she had conducted the company's affairs in disregard of the shareholder's interests and the latter wished to have their shares purchased, then an unfair prejudice was appropriate[2]. In a more recent derivative claim, *Stainer v Lee*[3], Roth J referred approvingly to Millett J's judgment, and in *LPD Holdings (Aust) Pty Ltd v Phillips*[4] the Queensland Supreme Court recently took the same view as Millett J and said that in many cases conduct can have a dual character, namely actionable either as a derivative action or under the oppression provision (equivalent to the UK's s 994). In Canada it has been said that there is not a bright-line distinction between the claims that may be advanced under the derivative action section and those that may be brought under the oppression provision[5]. This is undoubtedly correct as far as the UK is concerned.

1 *[1990] BCLC 760* at 783.

2 [1990] BCLC 760.

3 *[2010] EWHC 1539 (Ch)*, *[2011] BCC 134* at [51].

4 *[2013] QSC 225* at [40]–[42].

5 *Malata Group (HK) Ltd v Jung 2008 ONCA 11* per Armstrong JA. This view was also expressed by Basten JA in *Campbell v Back Office Investments Pty Ltd [2008] NSWCA 95* at [214].

[14.127]

It would seem that there are several potential problems and concerns with permitting unfair prejudice petitions where the company has been wronged. For instance, the company does not benefit usually by relief granted in s 994 petitions, and hence, the other shareholders do not benefit indirectly; an order providing for a buy out of the shareholder in a s 994 case is of no assistance to the company. Also, non-shareholder stakeholders do not benefit. The riposte to that might be that as far as shareholders are concerned it is up to them to take action themselves. But, of course, some shareholders might not have the resources. As far as other stakeholders, who might benefit indirectly from the company being awarded relief in a derivative action, are concerned, they simply do not have any right to bring proceedings. This might be a particularly important issue for creditors where the company is in financial distress.

[14.128]

In completing this section of the chapter, it is submitted that the following cautionary words emitted by Brenda Hannigan need to be taken into account[1]:

> "The important point is that issues as to the appropriateness of petitions or derivative claims are not solely matters of choice for the aggrieved shareholder, but matter of jurisdiction for the court, which in resolving the issue must be mindful of the fundamental principles underlying the rule in *Foss v Harbottle*, the derivative claim and the rule against recovery of reflective loss.
>
> It is time to develop a workable derivative claim and the courts should continue to be very cautious about allowing corporate relief to be sought and granted on an unfairly prejudicial petition."

1 B Hannigan 'Drawing Boundaries Between Derivative Claims and Unfairly Prejudicial Petitions' [2009] JBL 606 at 626.

9 Views of members with no personal interest in the matter

[14.129]

The final factor, contained in s 263(4) of the CA 2006, that the courts must take into account is that they must consider any evidence before them as to the views of members of the company who have no personal interest in the matter. This was introduced to address the fact that it would not be either practical or desirable for large quoted companies to seek formal approval of the commercial decisions of the board from the shareholders[1].

[1] A Reisberg *Derivative Actions and Corporate Governance* (OUP, 2007) at 147.

[14.130]

It might seem, at first blush, that the views of the members identified in the subsection are to be accorded special consideration given the fact that it says that the court is to give 'particular regard' to their views, but in fact the introductory words of s 263(3) also refer to the court taking into account 'in particular' the factors set out in the subsection. Thus the factors in s 263(3) and the one in s 263(4) are of equal strength.

[14.131]

There has not been a lot said in relation to the issue of independent shareholders. It is not clear to whom the subsection is actually directed[1]. As Lewison J said in *Iesini*[2], the provision is not easy to understand as all members have an interest in any claim that is taken on behalf of the company because the value of their shares could rise or fall depending on the result of the claim[3]. After considering the provision's various interpretations Lewison J said that he was of the opinion that it was referring to those members who were 'not implicated in the alleged wrongdoing and who did not stand to benefit otherwise than in their capacity as members of the company'[4]. The potential problem is it might not always be possible to determine at the stage of the permission hearing whether members are able to benefit in a way that is out of the ordinary and in the way mentioned by his Lordship, but to be fair his Lordship's approach seems to be appropriate, sensible and as practicable as anything could be.

[1] The Law Commission said that the position at common law was not clear: *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com, No 246, Cm 3769) (London, Stationery Office, 1997) at para 6.89.

[2] *[2009] EWHC 2526, [2010] BCC 420* at [86].

[3] [2009] EWHC 2526, [2010] BCC 420 at [129].

[4] [2009] EWHC 2526, [2010] BCC 420.

[14.132]

It is difficult to know what sort of emphasis a court will put on this criterion. HH Judge Pelling QC (sitting as a judge of the High Court) in *Stimpson* noted the views of some of the members[1] and they gave limited support to the applicant. The judge said that he would take this into account, but the upshot was that it made little difference to the judge's opinion. In *Bridge v Daley*[2] HH Judge Hodge QC (sitting as a judge of the High Court) held that disinterested members of the company, save for a few minority shareholders who supported the applicant, were against a continuation of the action. There is no indication from his Lordship the weight put on that finding, but it seemed to be significant along with the fact that he found that no reasonable director would support the continuation of the action in the circumstances.

[1] [2009] EWHC 2072, [2010] BCC 387 at [42].

[2] *[2015] EWHC 2121 (Ch)*.

[14.133]

In *Kleanthous v Paphitis*[1] there were three shareholders. These were the claimant, the main respondent (a director and majority shareholder of the company), and the third shareholder, C (a minority shareholder and director). Newey J examined the views of C when he came to consideration of s 263(4) even though he was a named respondent[2]. This appears to be somewhat contrary to what Lewison J said in *Iesini*. While Newey J had come to the conclusion that C, the 'independent' member, had not benefited from the actions about which the claimant was complaining, it was surely an issue that should be resolved at a final hearing. In any event, given both the fact that C was a director sitting on the company's board when it approved of the actions of the main respondent and majority shareholder, and the fact that C arguably appeared 'to be close' to the majority shareholder, it is difficult to see why he could be characterised as not having a personal interest, at least one that was indirect, in the outcome.

[1] *[2011] EWHC 2287 (Ch)*.

[2] [2011] EWHC 2287 (Ch) at [83].

[14.134]

Clearly an issue that could well be considered when taking into account this criterion is whether the independent shareholders have been informed about the proceedings and the allegations made in them[1]. Where shareholders have not been properly informed this will reduce the weight that can be attached to their views.

[1] See *Stainer v Lee [2011] EWHC 2287 (Ch)*, *[2011] BCC 134* at [45]–[46].

Directors' Duties/Chapter 14 Derivative Claims/III The criteria for determining whether permission will be granted/B The best interests of the company

B The best interests of the company

[14.135]

The Law Commission in its report on *Shareholder Remedies*[1] indicated that a court should take into account the interests of the company in deciding whether to permit a derivative claim to go ahead[2]. However, the legislation that was subsequently drafted did not refer expressly[3] to the need for the applicant to establish that the derivative claim would be in the best interests of the company. Nevertheless, the UK legislation does instruct the court, in s 263(2)(a), and s 263(3)(b) of the CA 2006 to consider the importance that a person acting in accordance with s 172 (duty to promote the success of the company) would attach to continuing the claim. The meaning of s 172 has been the subject of interesting commentary from academics and practitioners[4], and it was discussed in detail in CHAPTER 6. Clearly the s 172 duty is tied up with the idea of acting in the best interests of the company, as made clear in *Re West Coast Capital (LIOS) Ltd*[5] and *Cobden Investments Ltd v RWM Langport Ltd*[6]. And it is unlikely that a UK court would grant permission unless it was convinced that the claim would be in the best interests of the company. Also, as ss 263 and 264 do not purport to state the only factors that a court may take into account, it would seem permissible for a court to consider whether an action was in the best interests of the company.

1 Law Commission *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at paras 6.77–6.79.

2 However, the Law Commission did not think that the fact that the derivative action was not in the interests of the company should mean that the court was bound to refuse leave: Law Commission *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at para. 6.80.

3 This was the only criteria recommended by the Law Commission that was not adopted in the legislation.

4 For instance, see A Keay 'Enlightened Shareholder Value, the Reform of the Duties of Company Directors and the Corporate Objective' [2006] LMCLQ 335; S Kiarie 'At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road Should the United Kingdom Take?' (2006) 17 *International Company and Commercial Law Review* 329; D Fisher 'The Enlightened Shareholder – Leaving Stakeholders in the Dark: Will Section 172(1) of the Companies Act 2006 Make Directors Consider the Impact of Their Decisions on Third Parties?' (2009) 20 *International Company and Commercial Law Review* 10; A Alcock 'An Accidental Change to Directors' Duties? (2009) 30 *Company Lawyer* 36; A Keay *Enlightened Shareholder Value Principle and Corporate Governance* (Abingdon, Routledge, 2013).

5 *[2008] CSOH 72* (Outer House, Court of Sessions, Lord Glennie) at [21].

6 *[2008] EWHC 2810 (Ch)*.

[14.136]

The Australian courts have discussed this concept frequently because the Australian legislation, as does the Canadian legislation[1], lays it down as a criterion for determining whether permission should be given to proceed with a derivative action and therefore the jurisprudence in these jurisdictions may be of some assistance.

1 Canada Business Corporations Act 1985, s 239(2)(c).

[14.137]

The inclusion of best interests as a requirement is a recognition in Australia that a company might well have reasonable business reasons for not pursuing a cause of action[1]. The Australian courts, as well as those in Canada and New Zealand, have emphasised the fact that the requirement is that the claim *must* be in the best interests of the company, and an applicant cannot merely establish that the claim *appears to be* or is *likely to be* in the best interests of the company[2]. So the court is not invited to enter into some form of 'crystal ball gazing' – it must be satisfied on the facts that the action would be in the company's best interests. To establish this involves an applicant doing more than making out a prima facie case in this respect[3]. It has been held that the personal qualities of the applicant do not come into play in determining this condition[4], for the focus is on the company. The applicant is required to adduce evidence in relation to[5]: the character of the company (is it a small or large company; is it a family company?); the business conducted by the company, in order to ascertain the effects of the proposed litigation on the proper conduct of the business; enabling a court to determine whether the substance of the relief that the applicant is seeking can be obtained without litigation; and the ability of the respondent to satisfy at least a substantial part of any order made in favour of the company in the proposed derivative action.

1 Explanatory Memorandum to the Corporate Law Economic Reform Program Bill at para 6.38.

2 For instance, see *Swansson v Pratt [2002] NSWSC 583, (2002) 42 ACSR 313* at [55]–[56].

3 *Re Bellman and Western Approaches Ltd (1981) 130 DLR (3d) 193* at 201; *Vrij v Boyle (1995) 3 NZLR 763* at 765; *Techflow (NZ) Ltd v Techflow Pty Ltd (1996) 7 NZCLC 261*, w138; *Swansson v Pratt [2002] NSWSC 583, (2002) 42 ACSR 313* at [55]–[56].

[4] *Maher v Honeysett & Maher Electrical Contractors Pty Ltd [2005] NSWSC 859* at [46]–[49].

[5] *Swansson v Pratt [2002] NSWSC 583*, *(2002) 42 ACSR 313* at [57]–[60].

[14.138]

Whether or not the best interests of the company are fulfilled by permitting a derivative action is an objective test under the Australian provision[1]. Although neither the legislation nor the cases require it[2], it has been argued that this assessment should involve a cost/benefit analysis[3]. The court might want the following kind of evidence to be adduced: how the proposed litigation will affect the proper conduct of the company's business; whether the substance of the relief sought is available by some other means; and the ability of the defendant to meet, at least, a substantial part of any judgment made in favour of the company[4].

[1] *Talisman Technologies Inc v Qld Electronic Switching Pty Ltd [2001] QSC 324* at [31].

[2] *Metyor Inc v Queensland Electronic Switching Pty Ltd [2002] QCA 269*, *(2002) 42 ACSR 398* at [19].

[3] P Prince 'Australia's Statutory Derivative Action: Using the New Zealand Experience' (2000) 18 *Company and Securities Law Journal* 493 at 504.

[4] *Swansson v Pratt [2002] NSWSC 583*, *(2002) 42 ACSR 313* at [58]–[60].

[14.139]

In Australia it has been said that where the company is insolvent, and even when it is in financial difficulties short of insolvency, the issue of the best interests of the company really involves deciding whether the claim would be in the interests of the creditors[1]. This is consistent with the fact that the common law in both the UK and Australia (and many parts of the Commonwealth) provides that directors, in discharging their duties to their company, have to take into account creditors' interests when their company is in financial difficulty[2]. This whole issue was discussed in detail in CHAPTER 13, and now involves some consideration of s 172(3) of CA 2006. UK courts might well consider creditor interests as part of their assessment, because of the fact that they are required to refuse permission to continue a derivative claim if a person acting in accordance with s 172 of the CA 2006 (duty to promote the success of the company) would not seek to continue the claim. Section 172 does provide in sub-s (3) that the duty imposed by s 172(1) has effect subject to any law that requires directors, in certain circumstances, to consider the interests of creditors.

[1] For example, see *Charlton v Baber [2003] NSWSC 745*, *(2003) 47 ACSR 31* at [53]; *Chahwan v Euphoric Pty Ltd [2006] NSWSC 1002* at [28]; *Promaco Conventions Pty Ltd v Dedline Printing Pty Ltd [2007] FCA 586* at [41].

[2] *Liquidator of West Mercia Safetywear v Dodd (1988) 4 BCC 30*; *Facia Footwear Ltd (in administration) v Hinchliffe [1998] 1 BCLC 218*; *Re Pantone 485 Ltd [2002] 1 BCLC 266*; *Gwyer v London Wharf (Limehouse) Ltd [2002] EWHC 2748 (Ch)*, *[2003] 2 BCLC 153*; *Re MDA Investment Management Ltd [2003] EWHC 227 (Ch)*, *[2004] BPIR 75*; *Kinsela v Russell Kinsela Pty Ltd (1986) 4 ACLC 215*, *(1986) 10 ACLR 395*; *Jeffree v NCSC (1989) 7 ACLC 556*, *(1989) 15 ACLR 217*; *Spies v The Queen [2000] HCA 43*, *(2000) 201 CLR 603*, *(2000) 173 ALR 529*. See A Keay *Company Directors' Responsibilities to Creditors* (Abingdon, Routledge-Cavendish, 2007) at 153–220.

Directors' Duties/Chapter 14 Derivative Claims/III The criteria for determining whether permission will be granted/C Costs

C Costs

[14.140]

It is trite to say that the matter of costs is an issue in any litigation. It is perhaps the foremost obstacle for shareholders in initiating and pursuing a derivative action. In one empirical study it was concluded in Australia, which has a very similar statutory system to that in the UK, that the low numbers of derivative actions was due largely to the cost of taking proceedings[1]. A shareholder might have to secure litigation insurance or, like the shareholder in *Hughes v Weiss*[2], come to an agreement with his or her solicitors that they act on a conditional fee basis as well as having insurance. In considering costs shareholders not only have to concern themselves with their own costs, they must accept that if the action fails the court might well order costs against them in line with the usual practice in the UK of costs following the result.

1 R Tomasic 'Corporations Law Enforcement Strategies in Australia: The Influence of Professional, Corporate and Bureaucratic Cultures' (1993) 3 *Australian Journal of Corporate Law* 192 at 221.

2 *[2012] EWHC 2363 (Ch)* at [55].

[14.141]

At common law the courts were able to order the company to indemnify a shareholder when granting permission to the shareholder to pursue a derivative action. This use of indemnification goes back to *Wallersteiner v Moir (No 2)*[1]. The power to make such an order is now found in r 19.9E of the Civil Procedure Rules. It provides that a court *may* order the company to indemnify the shareholder bringing the derivative action against any costs incurred in relation to the permission application or the derivative action or both. This means that a court may indemnify a shareholder/applicant in relation to his or her own costs as well as an adverse order for costs made against the shareholder[2]. If a costs order of this nature is to be made, it is normal to make it at the permission stage. It appears that the comments in a number of cases that considerable care should be taken by courts when deciding to order an indemnity[3] has turned into a general reluctance on the part of courts in the UK[4] to order any indemnity let alone an unrestricted indemnity. For example, in relation to the latter point indemnity orders have been made in two cases, *Kiani v Cooper*[5] and *Stainer v Lee*[6], where permission to continue the derivative action was granted, but to a limited extent. In the former case Proudman J said that the indemnity order did not cover any adverse costs order made, and in the latter, Roth J placed an upper level of £40,000 but with liberty to apply for an extension of the order. In a case where a shareholder was successful in obtaining permission, *Parry v Bartlett*[7], the court made no order concerning indemnity of costs. This could have been because there was no application for costs, but that is unlikely and we are not told in the judgment that that was the situation. The preliminary hearing to get permission is often robustly challenged and means that costs could be relatively high. All of this might well dissuade a shareholder from taking action.

1 *[1975] QB 373*.

2 *Bhullar v Bhullar [2015] EWHC 1943 (Ch)* at [49].

3 *Bhullar v Bhullar [2015] EWHC 1943 (Ch)* at [69].

4 This is also the case in Australia. For example, see *Swansson v Pratt (2002) 20 ACLC 1594*; I Ramsay and B Saunders 'Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action' (2006) 6 JCLS 397.

5 *[2010] EWHC 577 (Ch), [2010] BCC 463*.

6 *[2010] EWHC1539 (Ch), [2011] BCC 134*.

7 *[2011] EWHC 3146 (Ch)*.

[14.142]

If a court is minded to award an indemnity as to costs the impecuniosity of the claimants is not an issue[1].

1 *Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch)*, *[2010] BCC 420* at [125].

[14.143]

Some judgments given under the statutory scheme have provided, as did several cases decided at common law, some encouragement on the costs front to would-be applicants for permission. *Carlisle & Cumbria United Independent Supporters' Society Ltd v CUFC Holdings Ltd*[1] was a case which involved an appeal from a costs order made in relation to a claim relating to a breach of a director's duty, but which had been settled before the application to obtain permission to continue the claim as a derivative action was determined. Arden LJ said: 'As the action was a derivative action on behalf of the club, the trust [the applicant] had an expectation of receiving its proper costs from the companies on an indemnity basis if the action had gone forward …[2]'. In *Stainer v Lee*[3] Roth J said that a shareholder who obtains the permission of the court to proceed 'should *normally* be indemnified as to his reasonable costs by the company'[4]. In *Bridge v Daley*[5], while HH Judge Hodge QC did not grant permission he did imply that if he had done so then the applicant would be entitled to indemnification of costs[6]. This is consistent with comments from judges in other Commonwealth jurisdictions. For instance, Barrett J of the New South Wales Supreme Court in *Foyster v Foyster Holdings Pty Ltd*[7] embraced the views of many commentators when he said that shareholders are deserving of their costs because in legitimate cases they have been forced to embrace the derivative action process in order to protect the company and as their actions are necessary because the normal decision-makers of the company have not been forthcoming, they should not be required to fund the proceedings. But, as suggested earlier, other English judges, both when deciding matters at common law[8] and under the statutory scheme, have tended to be more cautious when it comes to ordering an award of costs in the context of derivative actions, and the circumstances in which an order is to be made are rather obscured[9]. Judges have emphasised the fact that the issue of costs is a matter for the judge's discretion in each case[10]. The recent case law clearly demonstrates that the expectation referred to by Arden LJ in the previous paragraph is not being fulfilled as the judges appeared to have taken their right to use their discretion as tantamount to providing a basis for not granting a costs order.

1 *[2010] EWCA Civ 463*, *[2011] BCC 855*.

2 [2010] EWCA Civ 463, [2011] BCC 855 at [8] and referring to *Wallersteiner v Moir (No 2)*.

3 *[2010] EWHC 1539 (Ch)*.

4 [2010] EWHC 1539 (Ch) at [56] (my emphasis).

5 *[2015] EWHC 2121 (Ch)*.

6 [2015] EWHC 2121 (Ch) at [86].

7 *[2003] NSWSC 135* at [13].

8 For example, see *McDonald v Horn [1995] 1 All ER 961* at 974.

9 C Paul 'Derivative Actions under English and German Law' (2010) ECFR 81 at 96.

10 For instance, see *Hook v Summer [2015] EWHC (Ch) 3820* at [139].

[14.144]

A study[1] found that the cautious approach of the English courts[2] is manifested by the fact that in only two of the nine cases[3] where the shareholder has been successful under the statutory regime, from the time when the scheme was put in force until 1 April 2016, has the court granted costs, and in all of these cases it declined to grant costs without limit. For instance, as indicated earlier, in *Stainer v Lee*[4] Roth J ordered an indemnity to a limit of £40,000. Therefore, since the advent of the statutory scheme there is no English case that has granted a successful applicant an unlimited indemnity for costs. In other Commonwealth jurisdictions the courts have been more generous. In New Zealand the courts have awarded costs in 37.5 per cent of cases where leave was sought, and while this might not seem to be significant, one must remember that courts have given permission in far more cases when compared with their UK counterparts, so we are dealing with larger numbers, and in 40 per cent of the cases where no order as to costs was made the applicant actually did not seek an order in relation to costs[5]. Since the study in 2016 there does not seem to have been any change in the courts' attitude to awarding costs.

1 A Keay 'Assessing and Rethinking the Statutory Scheme for Derivative Actions Under the Companies Act 2006' (2016) 16 *Journal of Corporate Law Studies* 39.

2 Also the position in Australia: I M Ramsay and B Saunders 'Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action' (2006) 6 JCLS 397 at 432.

3 But the applicant in one case where permission was given, *Cullen Investments Ltd v Brown [2015] EWHC 473 (Ch), [2015] BCC 539* did not seek an order that the company fund the litigation.

4 *[2010] EWHC 1539 (Ch)* at [56].

5 L Taylor 'The Derivative Action in the Companies Act 1993: An Empirical Study' (2006) 22 *New Zealand Universities Law Review* 337 at 355.

[14.145]

In one decision, *Hook v Summer*[1], where permission was granted, the judge, HH Judge Cook, said that he would not order the applicant/shareholder to be indemnified as that would give him an unfair advantage because the dispute was effectively one between the shareholders[2]. This is not an isolated approach. In *Bhullar v Bhullar*[3] Morgan J adopted a similar view. In both of these cases there was a recognition that the dispute that was subject to the application involved a dispute between shareholders and that unfair prejudice proceedings could either have been brought in lieu of the derivative action[4] or the derivative action was 'a stepping stone towards … section 994 proceedings'[5].

1 *[2015] EWHC 3820 (Ch)*.

2 [2015] EWHC 3820 (Ch) at [141].

3 *[2015] EWHC 1943 (Ch)*.

4 *Hook v Summer [2015] EWHC 3820 (Ch)*.

5 *Bhullar v Bhullar [2015] EWHC 1943 (Ch)* at [70].

[14.146]

It does seem rather unfair and difficult to understand why a court would deny an indemnity for costs when an applicant for permission to continue derivative proceedings has jumped over all of the hurdles set for him or her in the two-stage process. It causes one to ask: what else must the applicant do? The problem is that there is nothing in the legislation or the rules of court that instructs the shareholder in this regard. The concern is that the shareholder is at the mercy of the court's discretion[1]. It has been suggested that to the extent that an applicant succeeds and costs are not ordered to be paid by the company, the company is unjustly enriched (and, possibly, so are other shareholders and non-shareholding stakeholders) as it gets the benefit from the efforts of the shareholder[2]. Further, if a court declines to award costs then a successful applicant might decide not to pursue the derivative action and this could mean that the ones who harmed the company get away scot free.

1 L Thai 'How Popular are Statutory Derivative Actions in Australia? Comparisons with the United States, Canada and New Zealand' (2002) 30 *Australian Business Law Review* 118 at 136.

2 J Wilson 'Attorney Fees and the Decision to Commence Litigation: Analysis, Comparison and an Application to the Shareholders' Derivative Action' (1985) 5 *Windsor Yearbook of Access to Justice* 142 at 177 and referred to in I M Ramsay 'Corporate Governance, Shareholder Litigation and Prospects for a Statutory Derivative Action' (1992) 15 *University of New South Wales Law Journal* 149 at 164.

[14.147]

Other jurisdictions are far more generous to shareholders. In Germany if a shareholder's action is admitted then he or she will be indemnified[1]. The following position applies in New Zealand[2]:

> "The court shall, on the application of the shareholder or director to whom leave was granted under section 165 to bring or intervene in the proceedings, order that the whole or part of the reasonable costs of bringing or intervening in the proceedings, including any costs relating to any settlement, compromise, or discontinuance approved under section 168, must be met by the company unless the court considers that it would be unjust or inequitable for the company to bear those costs."

1 C Paul 'Derivative Actions under English and German Law' (2010) ECFR 81 at 113.

2 Section 166.

Directors' Duties/Chapter 14 Derivative Claims/IV Following permission

IV FOLLOWING PERMISSION

[14.148]

If the court approves of the derivative claim, the litigation proceeds normally. The Civil Procedure Rules provide that the member is not able to discontinue, settle or compromise the claim without the permission of the court[1]. This requirement is an attempt to prohibit green-mailing, a practice which was mentioned earlier[2].

1 Part 19.9F

2 See above at 14.118.

[14.149]

The derivative claim will then be subject to all of the normal procedural matters that affect all litigation. Of course, if permission has been granted it might encourage the defendants to offer to settle the claim.

Directors' Duties/Chapter 14 Derivative Claims/V Common law proceedings and retrospective effect

V COMMON LAW PROCEEDINGS AND RETROSPECTIVE EFFECT

[14.150]

The right to issue derivative actions under the common law rules that existed prior to the enactment of the respective statutory derivative action scheme no longer apply, save where, as is discussed later, there is a multiple derivative action[1]. Section 260(2) of the CA 2006 states that a derivative claim can now only be brought under Pt 11 or in pursuance of an order of the court in unfair prejudice proceedings (now s 994 of the CA 2006)[2]. The provisions were designed to codify common law rules[3]. The Australian regime is even more express than the UK's, for it is stated in s 236(3) of the Corporations Act 2001 that 'the right of a person at general law to bring, or intervene in, proceedings on behalf of a company is abolished'. This has been interpreted by the Australian courts as displacing the common law derivative action[4]. This is clearly the case where the cause of action on which the applicant relies occurred after the derivative claim provisions were put in force. But what about where the cause of action pre-dated the point when the provisions came into force, but no action had been taken? Given the time that the statutory scheme has been in place this is likely to be a relatively rare occurrence as any action is likely to be time barred. If the cause of action did occur before the putting into force of the statutory regime should a derivative action be brought under the common law rules? The Australian case law takes the view that the legislation will apply[5]. The reason given is that the statute was intended to be remedial, that is ameliorating the problems with the common law situation, and to deny this effect to those whose rights had accrued before the legislation became enforceable would be to frustrate the remedial purpose[6]. Furthermore, the Victorian Supreme Court made the point in *Advent Investors Pty Ltd v Goldhirsch*[7] that the intention of the legislature was to promote certainty concerning the nature of the derivative action and to avoid confusion because of divergence of common law principles vis à vis the statutory provisions[8].

[1] It also applies to limited liability partnerships which are not covered by the statutory regime. See *Harris v Microfusion 2003 – 2 LLP* *[2016] EWCA Civ 1212*.

[2] This is something recommended by the Law Commission in 1997 as it was of the view that it would make things confusing if actions could also be brought at common law: Law Commission *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at paras 6.51–6.55.

[3] A Alcock, J Birds and S Gale *Companies Act 2006: The New Law* (Bristol, Jordan Publishing, 2007) at 163.

[4] *Chapman v E-Sports Club Worldwide Ltd [2000] VSC 403, (2000) 35 ACSR 462*; *Karam v ANZ Banking Group Ltd [2000] NSWSC 596, (2000) 34 ACSR 545*; *Braga v Braga Consolidated Pty Ltd [2002] NSWSC 603*; *Metyor Inc v Queensland Electronic Switching Pty Ltd [2002] QCA 269, (2002) 42 ACSR 398*.

[5] *Karam v ANZ Banking Group Ltd [2000] NSWSC 596, (2000) 34 ACSR 545*; *Advent Investors Pty Ltd v Goldhirsch [2001] VSC 59, (2001) 37 ACSR 529*; *Roach v Winnote Pty Ltd [2001] NSWSC 822*; *Cadwallader v Bajco Pty Ltd [2001] NSWSC 1193*; *Swansson v Pratt [2002] NSWSC 583, (2002) 42 ACSR 313*.

[6] *Karam v ANZ Banking Group Ltd [2000] NSWSC 596, (2000) 34 ACSR 545* at [27].

[7] *[2001] VSC 59*.

8 The Australian courts are required by s 109H of the Corporations Act 2001 to have regard for any remedial purpose in interpreting the said Act.

[14.151]

The Australian approach does seem to sit well with the fact the Law Commission's 1997 report recommended the complete replacement of the common law procedure with the statutory derivative action on the basis that if the former co-existed with a statutory scheme, there would be confusion[1], as appears to be the case in Hong Kong where the two schemes both apply, sitting alongside each other. However, the UK sections were said by the Explanatory Notes to the CA 2006 not to formulate a substantive rule to replace the rule in *Foss v Harbottle*, but rather to reflect the recommendation of the Law Commission that there should be a 'new derivative procedure with more modern, flexible and accessible criteria for determining whether a shareholder can pursue an action'[2]. Arguably, though, the notes were merely pointing out that the statutory scheme introduced a new and all-encompassing approach to addressing derivative actions. Secondary legislation appears to support this latter interpretation of the Notes as art 20(3) of Sch 3 to the Companies Act 2006 (Commencement No 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007[3] indicates, although not as clearly as one would like, that a derivative claim will only be allowed to proceed as a derivative claim, where the act complained of occurred before 1 October 2007 (the date of the commencement of Pt 11), if it would have been able to do so under the law in force immediately before Pt 11 was put in force. Hence, it would seem that where there is a cause of action that could be the subject of a derivative action, and it occurred before 1 October 2007, shareholders can only obtain permission to bring proceedings if they meet the requirements at common law[4]. The judgment of HH Judge Keyser QC in *Hughes v Weiss*[5] seems to support that although his Lordship did say that the court also must decide whether or not permission would be given under s 263. So, this means that the act complained of must be judged under both the statutory scheme and the common law. Where the act(s) complained of occurred partly before 1 October and partly after that then to the extent that the claim arises from acts or omissions that occurred before 1 October 2007 the law in force immediately before that date will apply.

1 Law Commission *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at para 6.51–6.55.

2 Law Commission *Shareholder Remedies: Report on a Reference under section 3(1)(e) of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at para 6.15 and quoted by the Explanatory Notes to the Companies Act 2006 at para 491.

3 SI 2007/2194. The Order came into force as far as this matter is concerned on 1 October 2007.

4 SI 2007/2194, Sch 3, art 20(2).

5 *[2012] EWHC 2363 (Ch)*.

Directors' Duties/Chapter 14 Derivative Claims/VI Companies in liquidation or insolvent

VI COMPANIES IN LIQUIDATION OR INSOLVENT

[14.152]

When a company enters liquidation a liquidator will investigate the affairs of the company and he or she will consider, inter alia, whether the company has any legal rights that it can enforce against others with the aim

of swelling the assets available for distribution to the creditors. As has been noted earlier in this book, a liquidator might well discover that directors have, in the past, breached their duties to the company. If that is the case then the liquidator might decide to take legal proceedings against the miscreant directors. But what if a liquidator decides not to, and this could be for a variety of reasons such as a belief that the risks of failing in a law suit are too high. Can a shareholder seek court permission to initiate derivative proceedings when the company is in liquidation and it is believed directors breached their duties? It is not intended to address the issue in any great depth as that has been done elsewhere[1], but a few comments are perhaps apposite.

[1] A Keay 'Can Derivative Proceedings be Commenced When a Company is in Liquidation?' (2008) 21 *Insolvency Intelligence* 49.

[14.153]

At common law the view seemed to be that no action could be brought by shareholders once a company had entered liquidation[1]. The rationale for this was that all claims relating to the company should be brought within the scope and control of the winding up, whether it is compulsory or voluntary[2].

[1] For example, see *Cape Breton Company v Fenn (1881) 17 Ch D 198*; *Ferguson v Wallbridge [1935] 3 DLR 66*; *Scarel Pty Ltd v City Loan & Credit Corporation Pty Ltd (1988) 12 ACLR 730*; *Fargro Ltd v Godfroy [1986] 1 WLR 1134*.

[2] *Ferguson v Wallbridge [1935] 3 DLR 66* at 84.

[14.154]

Since the statutory derivative action process was introduced into Australian law there have been a number of cases that have considered the issue at hand. Until recently it was probably possible to say that shareholders could seek permission to bring proceedings. The decisions that held this were all single judge decisions[1], but they were large in number. The number of cases that were in favour of shareholders being entitled to seek permission led Barrett J of the New South Wales Supreme Court to say in *Carpenter v Pioneer Park Pty Ltd*[2] that the situation was such that the matter was now settled in Australia. However, two appellate decisions, one of the Victorian Court of Appeal in *Malhotra v Tiwari*[3] and the other of the New South Wales Court of Appeal in *Chahwan v Euphoric Pty Ltd t/as Clay & Michel*[4] have disturbed that notion. Although not having to decide the issue, the Victorian Court of Appeal said that 'ordinarily, it is inappropriate to allow derivative proceedings to be brought when a company is in liquidation because it would require the court to permit another to supplant the liquidator as the personification of the company for that purpose'[5]. The New South Wales court in *Chahwan v Euphoric Pty Ltd t/as Clay & Michel* was more forthright in clearly stating that the derivative proceedings regime should not be available in circumstances where the company the subject of the leave application is in liquidation[6]. The latter decision is not binding on courts in Australian jurisdictions, other than New South Wales, although it is highly persuasive and in a subsequent decision of the Federal Court of Australia, *Pearl Coast Divers Pty Ltd v Cossack Pearls Pty Ltd*[7], Gilmour J followed *Chahwan*. To ensure consistency in the whole country it is likely that other courts will follow *Chahwan*.

[1] For example, see, *Brightwell v RFB Holdings Pty Ltd [2003] NSWSC 7*, *(2003) 44 ACSR 186 (NSW S Ct)*; *Charlton v Baber [2003] NSWSC 745*, *(2003) 47 ACSR 31 (NSW S Ct)*; *William Kamper v Applied Soil Technology Pty Ltd [2004] NSWSC 891* (NSW S Ct); *Mhanna v Sovereign Capital Ltd [2004] FCA 1040* (Aust Fed Ct); *Carpenter v Pioneer Park Pty Ltd [2004] NSWSC 1007*, *(2004) 186 FLR 104* (NSW S Ct); *Mhanna v Sovereign Capital Ltd [2004] FCA 1252* (Aust Fed Ct); *Chahwan v Euphoric Pty Ltd* [2006] NSWSC (NSW S Ct); *Scuteri v Lofthouse [2006] VSC 317*, *(2006) 202 FLR 1061* (Vic S Ct); *Promaco Conventions Pty Ltd v Dedline Printing Pty Ltd [2007] FCA 586* (Aust Fed Ct), (in the last case mentioned, Siopis J indicated that he only took this view because of the of the fact that the preponderance of judicial opinion was in favour of leave being given in liquidations (at [38]).

[2] *[2004] NSWSC 1007*, *(2004) 186 FLR 104* at [8].

[3] *[2007] VSCA 101*.

4 *[2008] NSWCA 52*.

5 [2007] VSCA 101 at [77].

6 [2008] NSWCA 52 at [124].

7 *[2008] FCA 927*.

[14.155]

The position taken by the court in *Chahwan v Euphoric Pty Ltd t/as Clay & Michel* appears to be in line with the position now in both New Zealand and Singapore. In *Hedley v Albany Power Centre Ltd (in liq)*[1], Wild J if the New Zealand High Court concluded, albeit tentatively, that there was general support for the view that the statutory derivative jurisdiction was not available when the company the subject of proceedings was in liquidation; but that, even if it was, it ought not to be exercised[2]. In *Petroships Investment Pte Ltd v Wealth-plus Pte Ltd*[3] the Singaporean Court of Appeal was quite clear in holding that when a company was in liquidation shareholders could not bring derivative proceedings.

1 *[2005] 2 NZLR 196*.

2 [2005] 2 NZLR 196 at [53].

3 *[2016] SGCA 17*.

[14.156]

In 2010 in *Cinematic Finance Ltd v Ryder*[1] Roth J said that derivative claims should not normally be brought on behalf of a company in liquidation (or administration). This suggests that an action would only able to be brought in exceptional circumstances[2]. This might leave some possibility of action although it would be very rare, whereas in Australia and Singapore (and possibly New Zealand) there seems to be no room whatsoever. In an English decision, *Montgold Capital LLP v Ilska*[3], the judge gave permission to a claimant where the company was subject to administration. The administration was tied up with a pre-pack under which the company's business had been sold off to the directors. The judge believed that the claimant put forward a realistic case for his claim concerning the directors' breach of duty. The claimant had also instituted proceedings against the administrators for breach of duty and for their removal as well as unfair prejudice proceedings against the directors. The judge opined that the allegations made by the claimant was best suited to being considered in a derivative claim[4]. He said that even if the company was insolvent, that was not a bar of itself to preventing a derivative claim[5]. One might conclude that the judge had before him exceptional circumstances and thus that is why he was willing to grant permission and this might not be considered as authority for obtaining permission in all or many situations where the company is insolvent and in some form of insolvency regime.

1 *[2010] EWHC 3387 (Ch)*, *[2012] BCC 797* at [22].

2 R Tan, 'Leave to Commence Derivative Proceedings and the Threshold Issue of Liquidation' (2016) 37 Co Law 342.

3 *[2018] EWHC 2982 (Ch)*.

4 [2018] EWHC 2982 (Ch) at [40].

5 [2018] EWHC 2982 (Ch) at [30].

[14.157]

Rather than looking at instituting derivative actions shareholders might look at a different approach. The courts have an inherent power to sanction the bringing of proceedings by members in the name of the company when the company is in liquidation. In *Ragless v IPA Holdings Pty Ltd (in liq)*[1] the Full Court of the Supreme Court of South Australia referred to the inherent power. Debelle J, in giving the leading judgment, noted that this has been the situation in England for many years[2]. One assumes that the power has, as it has in Australia[3], survived in the UK, and shareholders may seek to have courts exercise it. Another option might well be for the shareholder to seek, under s 167(3) or s 168(5) of the Insolvency Act 1986 in relation to companies subject to court winding up or under s 112 of the same statute for voluntary liquidation, to have the decision of the liquidator not to take action reviewed by a court[4].

1 *[2008] SASC 90*.

2 See, for example, *Cape Breton Co v Fenn* *(1881) 17 Ch D 198* at 208; *Fargro Ltd v Godfroy* *[1986] 1 WLR 1134* at 1136–1138.

3 *BL & GY International Co Ltd v Hypec Electronics Pty Ltd [2001] NSWSC 705*, *(2001) 19 ACLC 1622*; *Brightwell v RFB Holdings Pty Ltd [2003] NSWSC 7*, *(2003) 44 ACSR 186*; *Roach v Winnote Pty Ltd [2001] NSWSC 82*.

4 For a discussion of this power, see A Keay McPherson and Keay's *Law of Company Liquidation* (London, Sweet and Maxwell, 4th edn, 2018) at [9.114]–[9.116].

[14.158]

Of course, most companies that are in liquidation that is not a members' voluntary winding up will be insolvent. What about where a company is not in liquidation or administration, but is insolvent? It was held in *Cinematic Finance Ltd v Ryder*[1] that a member should not be granted permission when the company is insolvent, and this is probably because the creditors are the residual beneficiaries of the company's value and not the shareholders in such a situation. The problem with this is that if the company does not enter any formal insolvency regime, such as liquidation, there is no one who can bring proceedings on behalf of the company. Even if the company does enter a formal regime it could be some time before an office-holder will be able to institute proceedings and in all of this time the creditors are out of pocket.

1 *[2010] EWHC 3387 (Ch)*, *[2012] BCC 797*.

Directors' Duties/Chapter 14 Derivative Claims/VII Multiple derivative actions

VII MULTIPLE DERIVATIVE ACTIONS

[14.159]

A 'multiple-derivative' action[1] is a derivative action that is entitled to be brought by minority shareholders of a parent company for a breach of duty owed to a direct or indirect subsidiary, certainly where control of the subsidiary is not independent of the parent company's board[2]. These actions are designed to prevent corporate wrongdoers being insulated from judicial intervention[3].

1 Variations of it might be called 'double derivative claims' or 'triple derivative claims' depending on how many company layers are involved.

2 R Hollington *Shareholders' Rights* (London, Sweet and Maxwell, 5th edn, 2007) at 146.

3 *Waddington Ltd v Chan Chun Hoo Thomas [2008] HKCFA 63*, *(2008) 11 HKCFAR 370*, *[2009] 4 HKC 381*, [2009] 2 BCLC 82 at [66].

[14.160]

Despite the fact that the Law Commission[1] was of the view that multiple-derivative claims will be rare, they have caused some debate in the common law world, and they might well not be as rare as the Law Commission suggested. They can occur where one has a simple or complicated corporate group situation with layers of companies. It is trite to say that corporate groups are a frequent part of the commercial landscape. And there have been at least four cases in the UK in recent times.

1 *Shareholder Remedies: Report on a Reference under* section 3(1)(e) *of the Law Commissions Act 1965* (Law Com No 246, Cm 3769) (London, Stationery Office, 1997) at para 6.109–6.110.

[14.161]

Prior to the advent of the UK's statutory regime it was clear that shareholders could bring a multiple-derivative action in the UK[1]. For some time following the introduction of the statutory regime there was uncertainty as to whether that remained the case. The reason for this uncertainty was that Parliament made it clear that the statutory regime in the CA 2006 entirely swept away the previous common law regime, because the statutory regime provided for a comprehensive scheme[2].

1 See, *Wallersteiner v Moir (No 2)* [1975] QB 373; *Halle v Trax BW Ltd [2000] BCC 1020*; *Trumann Investment Group v Societe General SA* [2003] EWHC 1316 (Ch); *Airey v Cordell* [2006] EWHC 2728 (Ch), *[2007] BCC 785*.

2 This was confirmed by Briggs J in *Re Fort Gilkicker Ltd* [2013] EWHC 348 (Ch), *[2013] BCC 365* at [28].

[14.162]

Other jurisdictions have not been blighted by such uncertainty in recent times as they have had decisions making the position clear. In *Waddington Ltd v Chan Chun Hoo Thomas*[1] the Hong Kong Court of Appeal held that there was no objection to this kind of action. What was intended to be covered by this designation is that a shareholder in a holding company might bring a general law derivative action aimed at obtaining a remedy for a wholly owned subsidiary of that company for a wrong done to the subsidiary. The court said[2] that:

> "The circumstances of today, where large companies, particularly public companies, conduct their affairs with a multiplicity of subsidiary companies which are no more than assets wholly controlled and, in practice, virtually indistinguishable from the holding company, are very different from the days in which derivative actions were first devised. If it indeed be the case that a subsidiary company is no more than an asset which is controlled in much the same way as any other asset of a holding company, I cannot say that the law should deprive a shareholder of the holding company an opportunity to have a wrong righted, if that wrong was technically suffered by the subsidiary, but the effect of the wrong would resound to the holding company."

1 *[2006] HKCA 196*. This case involved what is sometimes called a 'double-derivative claim'.

[2] [2006] HKCA 196 at [30] per Rogers VP.

[14.163]

An appeal to the Hong Kong Court of Final Appeal[1] on this point was dismissed. The court noted that the application for permission was brought pursuant to the common law scheme (proceedings having been initiated before the advent of the statutory regime in 2005), but it accepted in dicta that a multiple derivative action was permitted under the Hong Kong derivative action scheme as the legislation did not abolish the common law process[2].

[1] *Waddington Ltd v Chan Chun Hoo Thomas [2008] HKCFA 63, (2008) 11 HKCFAR 370, [2009] 4 HKC 381, [2009] 2 BCLC 82.*

[2] See Companies Ordinance, sections 2 and 168BC to 168BG.

[14.164]

In the New South Wales case of *Oates v Consolidated Capital Services Pty Ltd*[1] X was the holding company of Y and Y was the holding company of Z. The applicant, a former officer of X (under the Australian legislation officers and former officers are entitled to apply for leave to bring derivative actions[2]) sought to bring proceedings against the directors of Y and Z for breach of duties owed to Y and Z. The court said that a double derivative action (a type of multiple-derivative claim) was contemplated by the Australian legislation[3], and the applicant would have been able to bring proceedings on behalf of Y in relation to breaches perpetrated against Y, if he had fulfilled the criteria set out in the legislation (which he did not, according to the judge). But the applicant was not entitled to bring a derivative action on behalf of Z as Y was the one who could apply for leave[4], and the applicant could not cause Y to apply for leave[5]. The main reason why the judge would have permitted a double derivative claim[6] is that s 236(1)(a)(i) of the Australian legislation provides that a claim may be brought by a member of the company or of a related body corporate, and a subsidiary would come within that expression. The approach taken in *Waddington* and *Oates* indicates that the courts are prepared to take a realistic view of the fact that companies do operate in corporate groups.

[1] *[2008] NSWSC 464.*

[2] Corporations Act 2001, s 236(1)(a)(ii). It is to be noted that New Zealand includes a similar provision of the Australian legislation. See Companies Act 1993, s 165(1)(a) (NZ).

[3] [2008] NSWSC 464 at [26], [34].

[4] [2008] NSWSC 464 at [35], [36].

[5] [2008] NSWSC 464 at [37].

[6] [2008] NSWSC 464 at [34].

[14.165]

But, the UK position is different from both Hong Kong and Australia. In relation to the former the common law remains in force and sits alongside the statutory regime. In the latter the legislation arguably provides specifically for multiple-derivative claims. Prima facie neither of these situations exists in the UK, that is, the common law derivative action does not exist any longer and the CA 2006 does not permit members of related corporate bodies to bring proceedings as does the Australian legislation.

[14.166]

Whether or not the UK courts would support multiple-derivative claims was not formally decided until the decision in *Re Fort Gilkicker Ltd*[1]. In that case Briggs J (as he then was) said that in determining what kind of effect the 2006 Act has wrought upon the common law derivative action is ultimately a question of construction of the legislation. And legislation is to be construed as only withdrawing common law rights if it does so expressly or by necessary implication[2]. His Lordship's conclusion was that the CA 2006 did not do away with the multiple-derivative claim[3]. His reasons were, first, there was before 2006 a common law procedural device which permitted claims in multiple-derivative situations[4]. Secondly, the CA 2006 provided a comprehensive statutory code in relation to derivative actions, and s 260 applied Ch 1 of Pt 11 only to that part of the old common law device that was labelled as derivative actions, leaving other instances of its application unaffected[5]. Thirdly, Parliament did not expressly abolish the whole of the common law derivative action in relation to companies[6]. Fourthly, the legislation could have easily have been drafted to indicate that it was intended to abolish all aspects of the common law processes, including multiple-derivative claims, and it did not[7]. Briggs J said that the court is, where necessary, prepared to permit derivative claims to be brought on behalf of companies in wrongdoer control by persons other than their immediate shareholders without regarding those cases as special, and in particular without thinking it necessary to distinguish between 'ordinary' and 'multiple' derivative actions[8].

1 *[2013] EWHC 348 (Ch), [2013] BCC 365.*

2 [2013] EWHC 348 (Ch), [2013] BCC 365 at [29].

3 [2013] EWHC 348 (Ch), [2013] BCC 365 at [44].

4 [2013] EWHC 348 (Ch), [2013] BCC 365.

5 [2013] EWHC 348 (Ch), [2013] BCC 365 at [45].

6 [2013] EWHC 348 (Ch), [2013] BCC 365 at [46].

7 [2013] EWHC 348 (Ch), [2013] BCC 365 at [47].

8 [2013] EWHC 348 (Ch), [2013] BCC 365 at [24].

[14.167]

Subsequently David Richards J (as he then was) *in Abouraya v Sigmund*[1] applied the judgment in *Re Fort Gilkicker Ltd*. While not specifically applying the latter case, although referring to it, Morgan J in *Bhullar v Bhullar*[2] also agreed that a multiple derivative action was subject to the common law rules that survived the statutory regime's enactment[3].

1 *[2014] EWHC 2777 (Ch).*

2 *[2015] EWHC 1943 (Ch).*

3 For a more recent case where permission was granted for a double derivative action, see *Tonstate Group Ltd v Wojakovski [2019] EWHC 857 (Ch), [2019] 2 BCLC 574.*

[14.168]

In *Abouraya v Sigmund*[1] David Richards J did say that the approach of the law in England would not prevent a multiple derivative claim being brought by a person who was a shareholder of a foreign company.

1 *[2014] EWHC 2777 (Ch).*

[14.169]

Certainly the judgment of Briggs J in *Re Fort Gilkicker Ltd* might be seen to have produced a just result, and it is to be applauded for that. However, aspects of the reasoning might not satisfy all commentators. Also, while the judgment solves one problem, it creates another in that we now have a dual system, namely the statutory scheme applying to 'ordinary' derivative claims, and the common law applying to multiple-derivative claims. It would be best if Parliament amended the Act to provide clearly for multiple-derivative claims, perhaps in a way that is similar to the Australian scheme.

Directors' Duties/Chapter 14 Derivative Claims/VIII Foreign derivative claims

VIII FOREIGN DERIVATIVE CLAIMS

[14.170]

An issue that was raised in the case of *Novatrust Ltd v Kea Investments Ltd*[1] was whether UK courts could still hear derivative claims that had been initiated in a foreign jurisdiction. In this case HHJ Pelling QC (sitting as a judge of the High Court) rejected the argument that the enactment of the statutory derivative regime meant that UK courts could only hear claims that were covered by the regime. The judge recognised that the regime did create a comprehensive code concerning the jurisdiction to entertain derivative claims, but he was of the opinion that this was only the case as far as claims to which it applied[2]. His Lordship went on to say that there was nothing in the regime that abrogated the common law rules that previously applied and as far as England and Wales were concerned the regime only applies to English and Welsh companies[3]. Thus the regime did not apply to foreign companies. This approach is consistent with the views expressed in *Re Fort Gilkicker Ltd*[4] and *Abouraya v Sigmund*[5], both of which were mentioned above in the context of multiple-derivative actions, and means that the regime had not abolished the whole of the existing common law relating to derivative claims.

1 *[2014] EWHC 4061 (Ch)*.

2 [2014] EWHC 4061 (Ch) at [27].

3 [2014] EWHC 4061 (Ch).

4 *[2013] EWHC 348 (Ch), [2013] BCC 365.*

5 [2014] EWHC 2777 (Ch).

Directors' Duties/Chapter 14 Derivative Claims/IX Appeals from derivative claim hearings

IX APPEALS FROM DERIVATIVE CLAIM HEARINGS

[14.171]

If permission is sought and secured by a claimant and then the claimant does not succeed with his or her action at the final hearing, does the claimant have to obtain a further grant of permission in order to appeal or to seek leave to appeal? This has not been answered by a UK decision, but the Federal Court of Australia has held that permission must be secured, and the ordinary principles that apply to any consideration of a grant of permission to continue a derivative action will be taken into account and applied in the decision of the court[1].

[1] *Wood v Links Golf Tasmania Pty Ltd [2013] FCA 143.*

Directors' Duties/Chapter 14 Derivative Claims/X The effect of the new procedure

X THE EFFECT OF THE NEW PROCEDURE

[14.172]

Joan Loughrey, Andrew Keay and Luca Cerioni[1] found in a study conducted before the derivative scheme took effect that lawyers believed that s 172 of the CA 2006 cannot be viewed in isolation from the new derivative action. Taken together these were described as likely to subject directors to a 'double whammy'[2]. It had been asserted that the new scheme would make it easier for activist shareholders and special interest groups to bring proceedings[3]. But, it would not appear that activist shareholders have, to date, availed themselves of the opportunity. Loughrey et al reported[4] that there was evidence before the new regime became operative of a widespread concern about derivative litigation amongst companies. In a survey undertaken by the law firm, Herbert Smith, 79 per cent of respondents believed that the CA 2006 would lead to an increased number of derivative actions. Although only 54 per cent were quite, or very, concerned about this, concern was mainly expressed by the smaller companies[5]. The concern over more litigation might have been based on the fact that shareholders might have more scope to bring proceedings compared with the situation that existed at common law. For example, at common law shareholders were not able, save where directors had benefited from their negligence, to initiate derivative actions against directors for negligence[6], whereas under the new statutory derivative scheme in Pt 11 of the CA 2006, shareholders are now able to bring proceedings where directors have been negligent, provided that permission can be secured from the court. Some lawyers suggested the fact that the new law allows actions to be launched against directors where they have been negligent, without any self-serving benefits for them, might permit activist shareholders to initiate a derivative action alleging that directors have negligently failed to have regard to one of the factors in s 172, or placed undue weight on other factors[7]. Also, some felt that there might well be more derivative actions because of the fact that it is arguably easier now to establish a breach of duties of care of directors. Not only was the likelihood of litigation mooted in client briefings, but, while the Bill, on which the CA 2006 is based, was passing through Parliament, there were very many high profile press stories, often based on lawyers' comments, to the effect that the new derivative action would increase litigation, and making the link between derivative litigation and s 172's predecessor clauses[8]. Loughrey et al found that lawyers were advising that while the risk of increased litigation is high, such litigation was unlikely to be successful[9]. The fact of the matter is that to date any concern that there would be an avalanche of proceedings has not been proved to be correct. As mentioned at various points in the chapter, there have been relatively few claims made. This could be for a number of reasons. First, benefits of the process will go to the company, so that might be why shareholders are reluctant to commence proceedings. Admittedly, the member might secure some benefit from an action, but they might be somewhat discouraged by the fact that other members will get a free ride as far as any benefits going to members are concerned, while they who take action will bear most of the risks. Second, in *Langley Ward Ltd v Trevor* the court commented that permission applications were 'set fair to become another time-consuming and expensive staple in the industry of satellite litigation'[10]. And this is something that any prospective applicants have to bear in mind; the concern is that they might be deterred from instituting legitimate derivative actions. Third, and allied to the last point, the member who is contemplating taking action is always in danger of having to pay legal and other costs.

1 'Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance' (2008) 8 *Journal of Corporate Law Studies* 79 at 96.

2 A phrase first used by Lord Hodgson of Astley Abbots in the Grand Committee Stage of the Bill, 27 Feb 2006, Hansard HL Vol 679, col GC2, and subsequently adopted by Herbert Smith *In the Line of Fire – Directors Duties under the Companies Act 2006*, at 4 and Mills and Reeve *Briefing*, October 2006; Clifford Chance *The Companies Act 2006* (November 2006) at 3–4; Not all lawyers took this approach – see Ashurst *The Companies Act 2006* (November 2006) at 3.

3 A Reisberg *Derivative Actions and Corporate Governance* (Oxford, OUP, 2007) at 146.

4 'Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance' (2008) 8 JCLS 79 at 97.

5 G Milner Moore and R Lewis (Herbert Smith) *In the Line of Fire – Directors Duties under the Companies Act 2006*, at 4.

6 *Daniels v Daniels [1978] Ch 406*.

7 G Milner Moore and R Lewis (Herbert Smith) *In the Line of Fire – Directors Duties under the Companies Act 2006* at 3; Norton Rose *Shareholder Rights*; Freshfields Bruckhaus Deringer *Companies Act 2006: Directors Duties* (November 2006) at 11; Clifford Chance *The Companies Act 2006* (November 2006) at 4.

8 See 'Directors on Guard Against Legal Action' *Financial Times*, 2 November 2005; 'Fears Weight of Law Will Fall on Directors' *Financial Times*, 3 May 2006; 'Bill leaves company's vulnerable on directors' duties' *Financial Times*, 8 May 2006; 'Company Law Reform' *Financial Times*, 9 May 2006; 'Threat to Directors Exaggerated, says Green Pressure Group' *Financial Times*, 12 May 2006.

9 (2008) 8 JCLS 79 at 105.

10 [2011] EWHC 1893 (Ch) at [61].

[14.173]

One commentator firmly stated in 2007 that the courts were likely to take as robust an approach with the statutory regime as they did under common law[1], and therefore the amount of litigation may well not increase significantly, and that has proved to be correct.

1 D Ohrenstein 'Derivative Actions' (2007) 157 NLJ 1372.

[14.174]

We should not be surprised by the fact that there have not been a large number of applications for permission. This was and continues to be the experience in Australia. A wide-ranging Australian study in 2005 found that there had only been 31 cases initiated in the five years since the derivative claim process was put into a statutory form, and this was not much of an increase on the number commenced under the common law procedure in the five years before codification[1].

1 I M Ramsay and B Saunders 'Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action' (2006) 6 JCLS 397 at 417.

[14.175]

As Reisberg has stated: 'Derivative claims provide an important mechanism by which shareholders can hold directors to account in exceptional and clearly defined circumstances'[1]. What we can conclude after nine

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years of the operation of the statutory scheme is that it is not providing a more accessible and more certain process. The fact is that the courts have kept a tight rein on the use of the derivative process[2]. Also, while one might argue that there has been a little more certainty introduced in the interpretation and application of the derivative action provisions in recent years, there remains some uncertainty concerning several criteria discussed in this chapter[3]. The foregoing, together with some of the issues raised earlier in the chapter, means that the following assertion appears to have merit[4]:

> "While the reforms were never meant to make it materially easier for shareholders to litigate on the company's behalf, it was intended that the criteria should be clearer than what existed at common law, that the concept of wrongdoer control should be discarded, and that the procedure should become more efficient and less lengthy and costly. There is a real risk that these objectives will not be met."

[1] *Derivative Actions and Corporate Governance* (Oxford, OUP, 2007) at 162.

[2] A Keay and J Loughrey 'An Assessment of the Present State of Statutory Derivative Proceedings' in J Loughrey (ed) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar, 2013), at 226.

[3] See, A Keay 'Assessing and Rethinking the Statutory Scheme for Derivative Actions Under the Companies Act 2006' (2016) 16 *Journal of Corporate Law Studies* 39 for a detailed discussion of the uncertainties and flaws in the scheme.

[4] A Keay and J Loughrey 'An assessment of the present state of statutory derivative proceedings' in J Loughrey (ed) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar, 2013), at 226 (footnote omitted).

Cayman Islands Grand Court Rules 1995

(Revised Edition)

Volume 1

ORDER 15

CAUSES OF ACTION, COUNTERCLAIMS AND PARTIES

Joinder of causes of action (O.15, r.1)

1. (1) Subject to rule 5(1), a plaintiff may in one action claim relief against the same defendant in respect of more than one cause of action –

(a) if the plaintiff claims, and the defendant is alleged to be liable, in the same capacity in respect of all the causes of action; or

(b) if the plaintiff claims or the defendant is alleged to be liable in the capacity of executor or administrator of an estate in respect of one or more or the causes of action and in his personal capacity but with reference to the same estate in respect of all the others; or

(c) with leave of the Court.

(2) An application for leave under this rule must be made ex parte by affidavit before the issue of the writ or originating summons, as the case may be, and the affidavit must state the grounds of the application.

Counterclaim against plaintiff (O.15, r.2)

2. (1) Subject to rule 5(2), a defendant in any action who alleges that he has any claim or is entitled to any relief or remedy against a plaintiff in the action in respect of any matter (whenever and however arising) may, instead of bringing a separate action, make a counterclaim in respect of that matter, and where he does so he must add the counterclaim to his defence.

(2) Rule 1 shall apply in relation to a counterclaim as if the counterclaim were a separate action and as if the person making the counterclaim were the plaintiff and the person against whom it is made a defendant.

(3) A counterclaim may be proceeded with notwithstanding that judgment is given for the plaintiff in the action or that the action is stayed, discontinued or dismissed.

(4) Where a defendant establishes a counterclaim against the claim of the plaintiff and there is a balance in favour of one of the parties, the Court may give judgment for the balance, so, however, that the provision shall not be taken as affecting the Court's discretion with respect to costs.

Counterclaim against additional parties (O.15, r.3)

3. (1) Where a defendant to an action who makes a counterclaim against the plaintiff alleges that any other person (whether or not a party to the action) is liable to him along with the plaintiff in respect of the subject matter of the counterclaim, or claims against such other person any relief relating to or connected with the original subject matter of the action, then, subject to rule 5(2) he may join that other person as a party against whom the counterclaim is made.

(2) Where a defendant joins a person as a party against who he makes a counterclaim, he must add that person's name to the title of the action and serve on him a copy of the counterclaim and, in the case of a person who is not already a party to the action, a form of acknowledgment of service in form No. 8 of Appendix I with such modification as the circumstances may require; and a person on whom a copy of a counterclaim is served under this paragraph shall, if he is not already a party to the action, become a party to it as from the time of service with the same rights in respect of his defence to the counterclaim and otherwise as if he had been duly sued in the ordinary way by the party making the counterclaim.

(3) A defendant who is required by paragraph (2) to serve a copy of the counterclaim made by him on any person who before service is already a party to the action must do so within the period within which, by virtue or Order 18, rule 2, he must serve on the plaintiff the defence to which the counterclaim is added.

(4) Where by virtue of paragraph (2) a copy of a counterclaim is required to be served on a person who is not already a party to the action, the following provision of these Rules, namely, Order 5, rule 1, Orders 10 to 13 and Order 75, rule 4, shall, subject to the last foregoing paragraph, apply in relation to the counterclaim and the proceedings arising from it as if –

(a) the counterclaim were a writ and the proceedings arising from it an action; and

(b) the party making the counterclaim were a plaintiff and the party against whom it is made a defendant in that action.

(5A) Where by virtue of paragraph (2) a copy of a counterclaim is required to be served on any person other than the plaintiff who, before service is already a party to the action, the provisions of Order 14, rule 5, shall apply in relation to the counterclaim and the proceedings arising therefrom, as if the party against the counterclaim is made were the plaintiff in the action.

(6) A copy of a counterclaim required to be served on a person who is not already a party to the action must be indorsed with a notice in Form No. 10 of Appendix I addressed to that person.

Joinder of parties (O.15, r.4)

4. (1) Subject to rule 5(1) two or more persons may be joined together in one action as plaintiffs or as defendants with the leave of the Court or where –

(a) if separate actions were brought by or against each of them, as the case may be, some common question of law of fact would arise in all the actions; and

(b) all rights to relief claimed in the action (whether they are joint, several or alternative) are in respect of or arise out of the same transaction or series of transactions.

(2) Where the plaintiff in any action claims any relief to which any other person is entitled jointly with him, all persons so entitled must, subject to the provisions of any Law and unless the Court gives leave to the contrary, be parties to the action and any of them who do not consent to being joined as a plaintiff must, subject to any order made by the Court on an application for leave under this paragraph, be made a defendant. This paragraph shall not apply to a probate action.

Court may order separate trials, etc. (O.15, r.5)

5. (1) If claims in respect of two or more causes of action are included by a plaintiff in the same action or by a defendant in a counterclaim, or if two or more plaintiffs or defendants are parties to the same action, and it appears to the Court that the joinder of causes of action or of parties, as the case may be, may embarrass or delay the trial or is otherwise inconvenient, the Court may order separate trials or make such other order as may be expedient.

(2) If it appears on the application of any party against who a counterclaim is made that the subject matter of the counterclaim ought for any reason be disposed of by a separate action, the Court may order the counterclaim to struck out or may order it to be tried separately or may make such other order as may be expedient.

Misjoinder and nonjoinder of parties (O.15, r.6)

6. (1) No cause or matter shall be defeated by reason of the misjoinder or nonjoinder of any party; and the Court may in any cause or matter determine the issues or questions in dispute so far as they affect the rights and interest of the persons who are parties to the cause or matter.

(2) Subject to the provisions of this rule, at any stage of the proceedings in any cause or matter the Court may on such terms as it thinks just and either of its own motion or on application –

(a) order any person who has been improperly or unnecessarily made a party or who has for any reason ceased to be a proper or necessary party, to cease to be a party;

(b) order any of the following persons to be added as a party, namely -

(i) any person who ought to have been joined as a party or whose presence before the Court is necessary to ensure that all matters in dispute in the cause or matter may be effectually and completely determined and adjudicated upon; or

(ii) any person between whom and any party to the cause or matter there may exist a question or issue arising out of or relating to or connected with any relief or remedy claimed in the cause or matter which in the opinion of the Court it would be just and convenient to determine as between him and that party as well as between the parties to the cause or matter.

(3) An application by any person for an order under paragraph (2) adding him as a party must, except with the leave of the Court, be supported by an affidavit showing his interest in the matters in dispute in the cause or matter or, as the case may be, the question or issue to be determined as between him and any party to the cause or matter.

(4) No person shall be added as a plaintiff without his consent signified in writing or in such other manner as may be authorised.

(5) No person shall be added or substituted as a party after the expiry of any relevant statutory period of limitation unless either –

(a) the relevant period was current at the date when proceedings were commenced and it is necessary for the determination of the action that the new party should be added, or substituted; or

(b) the relevant period arises under the provisions of Section 13 or 16 of the Limitation Law (1996 Revision) and the Court directs that those provisions should not apply to the action by or against the new party.

In this paragraph "any relevant period of limitation" means a time limit under the Limitation Law (1996 Revision).

(6) The addition or substitution of a new party shall be treated as necessary for the purposes of paragraph (5) if, and only if, the Court is satisfied that -

(a) the new party is a necessary party to the action in that property is vested in him at law or in equity and the plaintiff's claim in respect of an

equitable interest in that property is liable to be defeated unless the new party is joined; or

(b) the relevant cause of action is vested in the new party and the plaintiff jointly but not severally; or

(c) the new party is the Attorney General and the proceedings should have been brought by relator proceedings in this name; or

(d) the new party is a company in which the plaintiff is a shareholder and on whose behalf the plaintiff is suing to enforce a right vested in the company; or

(e) the new party is sued jointly with the defendant and is not also liable severally with him and failure to join the new party might render the claim unenforceable.

Proceedings against estates (O.15, r.6A)

6A. (1) Where any person against whom an action would have lain has died but the cause of action survives, the action may, if no grant of probate or administration has been made, be brought against the estate of the deceased.

(2) Without prejudice to the generality of paragraph (1), an action brought against "the personal representatives of A.B. deceased" shall be treated, for the purpose of that paragraph, as having been brought against his estate.

(3) An action purporting to have been commenced against a person shall be treated, if he was dead at its commencement, as having been commenced against his estate in accordance with paragraph (1) whether or not a grant of probate or administration was made before its commencement.

(4) In any such action as is referred to in paragraph (1) or (3) –

(a) the plaintiff shall, during the period of validity for service of the writ or originating summons, apply to the Court for an order appointing a person to represent the deceased's estate for the purpose of the proceedings or, if a grant of probate or administration has been made, for an order that the personal representative of the deceased be made a party to the proceedings, and in either case of an order that the proceedings be carried on against the person appointed or, as the case may be, against the personal representative, as if he had been substituted for the estate;

(b) the Court may, at any stage of the proceedings and on such terms as it thinks just and wither of its own motion or on application, make any such order as is mentioned in subparagraph (a) and allow such

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amendments (if any) to be made and make such other order as the Court thinks necessary in order to ensure that all matters in dispute in the proceedings may be effectually and completely determined an adjudicated upon.

(5) Before making an order under paragraph (4) the Court may require notice to be given to any insurer of the deceased who has an interest in the proceedings and to such (if any) of the persons having an interest in the estate as it thinks fit.

(6) Where an order is made under paragraph (4), rules 7(4) and 8(3) and (4) shall apply as if the order had been made under rule 7 on the application of the plaintiff.

(7) Where no grant of probate or administration has been made, any judgment or order given or made in the proceedings shall bind the estate to the same extent as it would have been bound if a grant had been made and a personal representative of the deceased had been a party to the proceedings.

Change of parties by reason of death, etc. (O.15, r.7)

7. (1) Where a party to an action dies or become bankrupt but the cause of action survives, the action shall not abate by reason of the dearth or bankruptcy.

(2) Where at any stage of the proceedings in any cause or matter the interest or liability of any party is assigned or transmitted to or devolves upon some other person, the Court may, if it thinks it necessary in order to ensure that all matters in dispute in the cause or matter may be effectually and completely determined and adjudicated upon, order that other person to be made a party to the cause or matter and the proceedings to be carried on as if he had been substituted for the first mentioned party.

An application for an order under this paragraph may be ex parte.

(3) An order may be made under this rule for a person to be made a party to a cause or matter notwithstanding that he is already a party to it on the other side of the record, or on the same side but in different capacity; but –

(a) if he is already a party on the other side, the order shall be treated as containing a direction that he shall cease to be a party on that other side; and

(b) if he is already a party on the same side but in another capacity, the order may contain a direction that he shall cease to be a party in that other capacity.

(4) The person on whose application an order is made under this rule must procure the order to be filed in the Register of Writs, and after the order has been filed

that person must, unless the Court otherwise directs, serve the order on every other person who is a party to the cause or matter or who becomes or ceases to be a party by virtue of the order and serve with the order on any person who becomes a defendant a copy of the writ or originating summons by which the cause or matter was begun and a form of acknowledgment of service in Form No. 8 or Form No. 9 of Appendix I, whichever is appropriate.

Any application to the court by a person served with an order made ex parte under this rule for the discharge or variation of the order must be made within 14 days after the service of the order on that person.

Provisions consequential on making of order under rule 6 or 7 (O.15, r8)

8. (1) Where an order is made under rule 6 the writ by which the action in question was begun must be amended accordingly and must be indorsed with –

(a) a reference to the order in pursuance of which the amendment is made; and

(b) the date on which the amendment is made,

and the amendment must be made within such period as may be specified in that order or, if no period is so specified, within 14 days after the making of the order.

(2) Where by an order under rule 6 a person is to be made a defendant, the rules as to service of a writ shall apply accordingly to service of the amended writ on him, but before serving the writ on him the person on whose application the order was made must procure the order to be filed in the Register of Writs.

(3) Where by an order under rule 6 or 7 a person is t be made a defendant the rules as to acknowledgment of service shall apply accordingly to acknowledgment of service by him subject, in the case of a person to be made a defendant by an order under rule 7, to the modification that the time limited for acknowledging service shall begin with the date on which the order is served on him under rule 7(4) or, if the order is not required to be served on him, with the date on which the order is to be filed in the Register of Writs.

(4) Where by an order under rule 6 or 7 a person is to be added as a party or is to be made a party in substitution for some other party, that person shall not become a party until -

(a) where the order is made under rule 6, the writ has been amended in relation to him under this rule and (if he is a defendant) has been served on him; or

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(b) where the order is made under rule 7, the order has been served on him under rule 7(4) or, if the order is not required to be served on him, the order has been field in the Register of Writs,

and where by virtue of the foregoing provision a person becomes a party in substitution for some other party, all things done in the course of the proceedings before the making of the order shall have effect in relation to the new party as they had in relation to the old, except that acknowledgment of service by the old party shall not dispense with acknowledgment of service by the new.

(5) The foregoing provisions of this rule shall apply in relation to an action begun by originating summons as they apply in relation to an action begun by writ,

Failure to proceed after death of party (O.15, r.9)

9. (1) If after the death of a plaintiff or defendant in any action the cause of action survives, but no order under rule 7 is made substituting as plaintiff any person in whom the cause of action vests or, as the case may be, the personal representative of the deceased defendant, the defendant or, as the case may be, those representatives may apply to the Court for an order that unless the action is proceeded with within such time as may be specified in the order the action shall be struck out as against the plaintiff or the defendant, as the case may be, who has died; but where it is the plaintiff who has died the Court shall not make an order under this rule unless satisfied that due notice of the application has been given to the personal representatives (if any) of the deceased plaintiff and to any other interested persons who, in the opinion of the Court, should be notified.

(2) Where in any action a counterclaim is made by a defendant, this rule shall apply in relation to the counterclaim as if the counterclaim were a separate action and as if the defendant making the counterclaim were the plaintiff and the person against whom it is made a defendant.

Actions for possession of land (O.15, r.10)

10. (1) Without prejudice to rule 6, the Court may at any stage of the proceedings in an action for possession of land order any person not a party to the action who is in possession of the land (whether in actual possession or by a tenant) to be added as a defendant.

(2) An application by any person for an order under this rule may be made ex parte, supported by an affidavit showing that he is in possession of the land in question and if by a tenant, naming him. The affidavit shall specify the applicant's address for service and Order 12, rule 3(2) and (3) shall apply as if the affidavit were an acknowledgment of service.

(3) A person added as a defendant by an order under this rule shall serve a copy of the order on the plaintiff giving the added defendant's address for the service specified in accordance with paragraph (2).

Actions in detinue, conversion or for trespass to goods (O.15, r.10A)

10A. (1) Where the plaintiff in an action in detinue, conversion or for trespass to goods is one of two or more persons having or claiming any interest in the goods, then, unless he has the written authority of every other such person to sue on the latter's behalf, the writ or originating summons by which the action was begun shall be indorse with a statement giving particulars of the plaintiff's title and identifying every other person who to his knowledge, has or claims any interest in the goods.

This paragraph shall not apply to an action arising out of an accident on land due to collision or apprehended collision involving a vehicle.

(2) A defendant to an action in detinue, conversion or for trespass to goods who desires to show that a third party has a better right that the plaintiff as respects all or any part of the interest claimed by the plaintiff may, at any time after giving notice of intention to defend, and before any judgment or order is given or made on the plaintiff's claim, apply for directions as to whether any person named in the application (not being a person whose written authority the plaintiff has to sue on his behalf) should be joined with a view to establishing whether he has a better right than the plaintiff, or has a claim as a result of which the defendant might be doubly liable.

(3) An application under paragraph (2) shall be made by summons, which shall be served personally on every person name in it as well as being served on the plaintiff.

(4) Where a person named in an application under paragraph (2) fails to appear on the hearing of the summons or to comply with any direction given by the Court on the application, the court may by order deprive him of any right of action against the defendant for the wrong, either unconditionally or subject to such terms and conditions as the Court thinks fit.

Relator actions (O.15, r.11)

11. Before the name of any person is used in any action as a realtor, that person must give a written authorisation so to use his name to his attorney and the authorisation must be filed the Court office.

Representative proceedings (O.15, r.12)

12. (1) Where numerous persons have the same interest in any proceedings, not being such proceedings as are mentioned in rule 13, the proceedings may be begun,

and, unless the Court otherwise order, continued, by or against any one or more of them as representing all of as representing all except one or more of them.

(2) At any stage of proceedings under this rule the Court may, on the application of the plaintiff, and on such terms, if any, as it thinks fit, appoint any one or more of the defendants or other persons as representing whom the defendants are sued to represent all, or all except one or more, of those persons in the proceedings; and where in exercise of the power conferred by this paragraph, the court appoints a person not named as a defendant, it shall make an order under rule 6 adding that person as a defendant.

(3) A judgment or order given in proceedings under this rule shall be binding on all the persons as representing whom the plaintiffs sue or, as the case may be, the defendants are sued, but shall not be enforced against any person not a party to the proceedings except with the leave of the Court.

(4) An application for the grant of leave under paragraph (3) must be made by summons which must be served personally on the person against whom it is sought to enforce the judgment or order.

(5) Notwithstanding that a judgment or order to which any such application relates is binding on the person against whom the application is made, that person may dispute liability to have the judgment or order enforced against him on the ground that by reason of facts and matters particular to this case he is entitled to be exempted from such liability.

(6) The Court hearing an application for the grant of leave under paragraph (3) may order the question whether the judgment or order is enforceable against the person against whom the application is made to be tried and determined in any manner in which any issue or question in an action may be tried and determined.

Derivative actions (O.15, r.12A)

12A. (1) This rule applies to every action begun by writ by one or more shareholders of a company where the cause of action is vested in the company and relief is accordingly sought on its behalf (referred to in this rule as a "derivative action").

(2) Where a defendant in a derivative action has given notice of intention to defend, the plaintiff must apply to the Court for leave to continue the action.

(3) The application must be supported by an affidavit verifying the facts on which the claim and the entitlement to sue on behalf of the company are based.

(4) Unless the Court otherwise orders, the application must be issued within 21 days after the relevant date, and must be served, together with the affidavit in support and any exhibits to the affidavit, not less than 10 clear days before the return

day on all defendants who have given notice of intention to defend; any defendant so served may show cause against the application by affidavit or otherwise.

(5) In paragraph (4), the relevant date means the later of –

(a) the date of service of the statement of claim;

(b) the date when notice of intention to defend was given, provided that,

where more than one notice of intention to defend is given, that date shall be the date when the first notice was given.

(6) Nothing in this rule shall prevent the plaintiff from applying for interlocutory relief pending the determination of an application for leave to continue the action.

(7) In a derivative action, Order 18, rule 2(1) (time for service of defence) shall not have effect unless the Court grants leave to continue the action and, in that case, shall have effect as if it required the defendant to serve a defence within 14 days after the order giving leave to continue, or with such other period as the Court may specify.

(8) On the hearing of the application under paragraph (2), the Court may –

(a) grant leave to continue the action, for such period and upon such terms as the Court may think fit;

(b) subject to paragraph (11), dismiss the action;

(c) adjourn the application and give such direction as to joinder of parties, the filing of further evidence, discovery, cross examination of deponents and otherwise as it may consider expedient.

(9) If the plaintiff does not apply for lave to continue the action as required by paragraph (2) within the time laid down in paragraph (4), any defendant who has given notice of intention to defend may apply for an order to dismiss the action or any claim made in it by way of derivative action.

(10) On the hearing of such an application for dismissal, the Court may –

(a) subject to paragraph (11), dismiss the action;

(b) if the plaintiff so requests, grant the plaintiff (on such terms as to costs or otherwise as the Court may think fit) an extension of time to apply for leave to continue the action; or

(c) make sure other order as may in the circumstances be appropriate.

(11) Where only part of the relief claimed in that action is sought on behalf of the company, the Court may dismiss the claim for that part of the relief under paragraphs (8) and (10), without prejudice to the plaintiff's right to continue the action as to the remainder of the relief and Order 18, rule 2(1) shall apply as modified by paragraph (7).

(12) If there is a material change in circumstances after the Court has given leave to the plaintiff to continue the action in pursuance of an application under paragraph (2), any defendant who has given notice of intention to defend may make an application supported by affidavit requiring the plaintiff to show cause why the Court should not dismiss the action or any claim made in it by way of derivative action. On such application the court shall have the same powers as it would have had upon an application under paragraph (2).

(13) The plaintiff may include in an application under paragraph (2) an application for an indemnity out of the assets of the company in respect of costs incurred or to be incurred in the action and the Court may grant such indemnity upon such terms as may in the circumstances be appropriate.

(14) So far as possible, any application under paragraph (13) and any application by the plaintiff under Order 14 shall be made so as to be heard at the same time as the application under paragraph (2).

Representation of interested person who cannot be ascertained, etc. (O.15, r.13)

13. (1) In any proceedings concerning –

(a) the estate of a deceased person; or

(b) property subject to a trust; or

(c) the construction of a written instrument, including a Law,

the Court, if satisfied that it is expedient so to do, and that one or more of the conditions specified in paragraph (20 are satisfied, may appoint one or more persons to represent any person (including an unborn person) or class who is or may be interested (whether presently or for any future contingent or unascertained interest) in or affected by the proceedings.

(2) The conditions of the exercise of the power conferred by paragraph (1) are as follows –

(a) that the person, the class or some member of the class, cannot be ascertained or cannot readily be ascertained;

(b) that the person, class or some member of the class, though ascertained, cannot be found;

(c) that, though the person or the class and the members thereof can be ascertained and found, it appears to the Court expedient (regard being had to all the circumstances, including the amount at stake and the degree of difficulty of the point to be determined) to exercise the power for the purpose of saving expense.

(3) Where in any proceedings to which paragraph (1) applies, the Court exercises the power conferred by that paragraph, a judgment or order of the Court given or made when the person or persons appointed in exercise of that power are before the Court shall be binding on the person or class represented by the person or person so appointed.

(4) Where, in any such proceedings, a compromise is proposed and some of the persons who are interested in, or who may be affected by, the compromise are not parties to the proceedings (including unborn or unascertained persons) but –

(a) there is some other person in the same interest before the Court who assents to the compromise or on whose behalf the Court sanctions the compromise; or

(b) the absent persons are represented by a person appointed under paragraph (1) who so assents,

the Court, if satisfied that the compromise will not be for the benefit of the absent persons and that it is expedient to exercise this power, may approve the compromise and order that it shall be binding on the absent persons, and they shall be bound accordingly except where the order has been obtained by fraud on non-disclosure of material facts.

Notice of action to non-parties (O.15, r.13A)

13A. (1) At any stage in an action to which this rule applies, the Court may, on the application of any party or of its own motion, direct that notice of the action be served on any person who is not a party thereto but who will or may be affected by any judgment given therein.

(2) An application under this rule may be made ex parte and shall be supported by an affidavit stating the grounds of the application.

(3) Every notice of an action under this rule shall be in Form No. 11 of Appendix I and accompanied by a copy of the originating summons or writ and a form of

acknowledgment of service in Form No. 8 or Form No. 9 of Appendix I with such modifications as may be appropriate.

(4) A person may, within 14 days of service on him of a notice under this rule, acknowledge service of the writ or originating summons and shall thereupon

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become a party to the action, but in default of such acknowledgment and the subject to paragraph (5) shall be bound by any judgment given in the action as if he were a party thereto.

(5) If at any time after service of such notice on any person the writ or originating summons is amended so as substantially to alter the relief claimed the Court may direct that the judgment shall not bind such person unless a further notice together with a copy of the amended writ or originating summons is served on him under this rule.

(6) This rule applies to any action relating to –

(a) the estate of a deceased person; or

(b) property subject to a trust.

Representation of beneficiaries by trustees, etc. (O.15, r.14)

14. (1) Any proceedings, including proceedings to enforce a security by foreclosure or otherwise, may be brought by or against trustees, executors or administrators in their capacity as such without joining any of the persons having a beneficial interest in the trust or estate, as the case may be and any judgment or order given or made in those proceedings shall be binding on those persons unless the Court in the same or other proceedings otherwise orders on the ground that the trustees, executors or administrators, as the case may be, could not or did not in fact represent the interests of those persons in the first-mentioned proceedings.

(2) Paragraph (1) is without prejudice to the power of the Court to order any person having such an interest as aforesaid to be made a party to the proceedings or to make an order under rule 13.

Representation of deceased person interested in proceedings (O.15, r.15)

15. (1) Where in any proceedings it appears to the Court that a deceased person was interested in the matter in question in the proceedings and that he has no estate representative, the Court may, on the application of any party to the proceedings, proceed in the absence of a person representing the estate of the deceased person or may by order appoint a person to represent that estate for the purposes of the proceedings; and any such order, and any judgment or order subsequently given or made in the proceedings, shall bind the estate of the deceased to the same extent as it would have been bound has an estate representative of that person been a party to the proceedings.

(2) Before making an order under this rule, the court may require notice of the application for the order to be given to such (if any) of the person having an interest in the estate as it thinks fit.

Declaratory judgment (O.15, r16)

16. No action or other proceeding shall be open to objection on the ground that a merely declaratory judgment or order is sought thereby, and the Court may make binding declarations of right whether or not any consequential relief is or could be claimed.

Conduct of proceedings (O.15, r.17)

17. The Court may give the conduct of any action, inquiry or other proceedings to such person as it thinks fit.

[2009 CILR 268]

RENOVA RESOURCES PRIVATE EQUITY LIMITED

v.

GILBERTSON and FOUR OTHERS

Grand Court

(Foster, Ag. J.)

14 April 2009

Civil Procedure—pleading—fraud—in pleading equitable fraud, not necessary to use words "dishonest" or "dishonesty" if acts self-evidently dishonest—allegation deemed implicit in pleading

Companies—derivative action—leave to continue action—on application for leave, to consider whether plaintiff has prima facie case on merits of claim on behalf of company and that alleged wrongdoing by majority of shareholders able to prevent claim—claim not to be unfounded or speculative, but to be bona fide, in interests of company and sufficiently strong

Companies—derivative action—leave to continue action—on application for leave, not to consider views of hypothetical board of directors unless plaintiff seeks indemnity costs from company—financial consequences of indemnity costs may require court to consider whether hypothetical board would approve expenditure

Companies—derivative action—multiple derivative action—to be permitted in appropriate circumstances when loss to subsidiary causes indirect loss to parent company and its shareholders

Companies—derivative action—reflective loss—to prevent double recovery of losses, parent company or shareholder not allowed to recover reflective loss mirroring that sustained directly by subsidiary—not to prevent shareholder or parent bringing derivative action for relief on behalf of subsidiary

Companies—directors—breach of fiduciary duty—exclusion of liability—irreducible core of obligations owed by fiduciary (duty to act honestly and in good faith) and thus claims for equitable fraud not to be excluded by exemption clause

The plaintiff company applied for leave to continue a derivative action, pursuant to O.15, r.12A(2) of the Grand Court Rules, in which the first and fifth defendants had given notice of their intention to defend.

The plaintiff company was owned by a holding company which was a member of a group of companies. The plaintiff owned 50% of the shares

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in the second defendant company with the other 50% being owned by a company of the first defendant, who was also one of its directors. An investment structure was established, pursuant to an agreement between the plaintiff's holding company and the first defendant, whereby the second defendant company was set up as the general partner of the third defendant company, which in turn was set up as the general partner of the fourth defendant, the master fund. The structure was established to enable ultimately the second defendant company and its shareholders to benefit from the acquisition and management of investments held by and through the master fund. The agreement provided that the first defendant would be in charge of developing and implementing the structure's investment funds.

The dispute between the parties arose over the acquisition of rights in a well-known commodity. The acquisition was initially proposed by the first defendant as an investment to be held within the investment structure but, without the consent or knowledge of the plaintiff or the second defendant company, he made alternative arrangements and purchased the rights using funds raised by the fifth defendant, a company owned by the first defendant, and two other investors. This meant that the investment structure was deprived of the opportunity to enjoy the benefits from managing the rights through the master fund as had been allegedly previously agreed.

The plaintiff brought a derivative action on behalf of the second defendant company alleging that (a) the first defendant, as director of that company, acted in breach of his fiduciary duties by diverting away from the company the valuable investment opportunity to acquire the rights; and (b) the fifth defendant company, also owned by the first defendant, had participated knowingly in this breach and consequently received the shares in the acquiring company as constructive trustee for the master fund and the rest of the investment structure. Since the defendants had given notice of their intention to defend, the plaintiff sought leave from the court to continue the action.

The plaintiff submitted that it should be granted leave to continue the action because (a) it had established a *prima facie* case since the first defendant had agreed that the rights would be acquired by a company in the group for the benefit of the investment structure and had instead diverted the opportunity away from the structure for his own personal benefit and in breach of his duties as director; and (b) the first defendant had an irreducible core of obligations which could not be excluded by the articles of association.

The first defendant submitted in reply that leave should not be granted because (a) the plaintiff would not only need to show a *prima facie* case but also that a hypothetical independent board of the company would have proceeded with the case; (b) he did not owe any duties in respect of the acquisition of the rights because this investment was always intended to be outside the investment structure; (c) further, he would have the benefit of indemnities in the articles of association which would exonerate him from

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liability in respect of any such agreement and that, anyway, the agreement between the parties was null and void so that no duties were owed; (d) the plaintiff had not explicitly pleaded dishonesty; and (e) there was no basis for giving leave for an action on behalf of the company since it had suffered no direct loss and any loss it did suffer would be reflective, for which the plaintiff would be unable to claim.

Held, granting the plaintiff leave to continue its action:

(1) The appropriate test to be adopted in considering an application for leave to continue a derivative action was that the court would have to be satisfied that the plaintiff had a *prima facie* case both in relation to the merits of the claim on behalf of the company, and that the alleged wrongdoing had been perpetrated by the majority of the shareholders, who were in a position to prevent the company from pursuing the claim against them. The requirement to obtain leave was to protect the defendant against and prevent the wasted expense and time of vexatious litigation. In deciding whether the plaintiff had shown a *prima facie* claim, the court would have to take a view of its merits, based on its first impressions of all the evidence presented, including that submitted by the defendant. The court would have to be satisfied that it was not unfounded or speculative, that it had been seriously brought on *bona fide* grounds in the interests of the company and that it was sufficiently strong to justify granting leave to continue the action rather than dismissing it at a preliminary stage. In the instant case, the court was satisfied that the plaintiff had a *prima facie* case against the defendants. The defendant director, with control of 50% of the shares in the company, was in a position to prevent the company from bringing a claim against him and, *prima facie*, his diversion of a valuable commercial opportunity away from the company for his own personal benefit was a breach of his fiduciary duties to the company. Leave would therefore be granted to continue the action pursuant to O.15, r.12A(2) of the Grand Court Rules (paras. 11–12; paras. 31–32; para. 35; para. 50; para. 73).

(2) When the court was considering whether the plaintiff should have leave to continue a derivative action, there was no need for it to concern itself with the views of a hypothetical board of directors. This test would only be necessary when a plaintiff sought indemnity costs from a company, since in such a case there would be financial consequences for the company and the court would need to consider hypothetically whether a reasonable board of directors would have approved the incurring of such costs. The plaintiff had made it clear that it did not intend to seek indemnity costs and, given there was no evidence that a hypothetical board would not have proceeded with the claim, the test was irrelevant (para. 24; paras. 30–32).

(3) The breach of the irreducible core of obligations owed by a fiduciary—the duty to act honestly and in good faith—and thus claims for equitable fraud could not be excluded by an exemption clause. Further, it

was not necessary for the plaintiff to have used the words "dishonest" or "dishonesty" in its pleadings since if the acts were self-evidently dishonest, the allegation would be deemed implicit in what was pleaded. Therefore, when considering this and the explicit exclusion of the dishonesty of a director in the indemnities in the company's articles of association, the first defendant had not shown a compelling argument that he would be exonerated through an indemnity or exclusion clause so that it was sufficient to justify the refusal of leave to the plaintiff to continue this action. Moreover, the fact that the agreement between the parties had subsequently been declared null and void was also irrelevant since the core fiduciary duties he owed in his capacity as director of the second defendant company were imposed as a matter of law and not derived from the written agreement (paras. 56–57; paras. 60–61; para. 72).

(4) In appropriate circumstances, a multiple derivative action—as in this case in which the plaintiff brought an action for losses incurred by a wholly-owned subsidiary of the company in which he was a shareholder—would be permitted, since any loss to the subsidiary caused indirect loss to its parent company and shareholders. A sub-subsidiary of the company, the master fund, had in this case sustained significant losses as a result of the actions of the first defendant, without the knowledge or consent of any of the companies in the investment structure, and in these circumstances, a multiple derivative action on behalf of the company would not be objectionable (para. 66).

(5) To prevent double recovery of losses, a shareholder or parent company would not be allowed to recover reflective loss, the indirect loss mirroring that suffered directly by the subsidiary. In the present case, the plaintiff as shareholder of the second defendant company would be permitted to bring a multiple derivative action on behalf of the master fund, but not a derivative action on behalf of the company, to recover compensation for loss reflective of that sustained by the master fund. It was clear that the plaintiff was seeking relief on behalf of the whole investment structure and so it was evident that this was not a derivative action to recover compensation for reflective loss and thus leave to continue the action would be granted (paras. 68–69).

Cases cited:

(1) *Airey v. Cordell*, [2007] Bus. L.R. 391; [2007] BCC 785; [2006] EWHC 2728 (Ch), not followed.

(2) *Armitage v. Nurse*, [1998] Ch. 241; [1997] 3 W.L.R. 1046; [1997] 2 All E.R. 705; [1997] Pens. L.R. 51; (1997), 74 P. & C.R. D13, followed.

(3) *Beddoe, In re, Downes v. Cottam*, [1893] 1 Ch. 547; (1892), 62 L.J. Ch. 233; 37 Sol. Jo. 99, referred to.

(4) *Bristol Fund Ltd., In re*, 2008 CILR 317, followed.

(5) *Edwards v. Halliwell*, [1950] 2 All E.R. 1064; [1950] W.N. 537; (1950), 94 Sol. Jo. 803, referred to.

(6) *Foss v. Harbottle* (1843), 2 Hare 461; 67 E.R. 189, referred to.

(7) *Johnson v. Gore Wood & Co.*, [2002] 2 A.C. 1; [2001] 2 W.L.R. 72; [2001] 1 All E.R. 481; [2001] 1 BCLC 313, considered.

(8) *Mumbray v. Lapper*, [2005] BCC 990; [2005] EWHC 1152 (Ch), not followed.

(9) *Nurcombe v. Nurcombe*, [1985] 1 W.L.R. 370; [1985] 1 All E.R. 65; [1984] BCLC 557, considered.

(10) *Prudential Assur. Co. Ltd. v. Newman Indus. Ltd. (No. 2)*, [1981] Ch. 257; [1980] 3 W.L.R. 543; [1980] 2 All E.R. 841; on appeal, [1982] Ch. 204; [1982] 2 W.L.R. 31; [1982] 1 All E.R. 354, followed.

(11) *Schultz v. Reynolds*, 1992–93 CILR 59, considered.

(12) *Smith v. Croft*, [1986] 1 W.L.R. 580; [1986] 2 All E.R. 551; [1986] BCLC 207, referred to.

(13) *Towers v. African Tug Co.*, [1904] 1 Ch. 558; (1904), 73 L.J. Ch. 395, referred to.

(14) *Viscount of Royal Ct. v. Shelton*, 1985–86 JLR 327; [1986] 1 W.L.R. 985; (1986), 2 BCC 99,134, referred to.

(15) *Waddington Ltd. v. Chan Chun Hoo*, [2008] HKEC 1498, followed.

(16) *Wallersteiner v. Moir (No. 2)*, [1975] Q.B. 373; [1975] 2 W.L.R. 389; [1975] 1 All E.R. 849, considered.

Legislation construed:

Grand Court Rules 1995, O.15, r.12A: The relevant terms of this rule are set out at para. 2.

R. Millett, *Q.C.* and *J.S. Eldridge* for the plaintiff;

R. Miles, *Q.C.* and *A. Choo Choy*, *Q.C.* for the first and fifth defendants.

1. **FOSTER, Ag. J.:** This is an application by the plaintiff, pursuant to O.15, r.12A(2) of the Grand Court Rules, for leave to continue a derivative action in which the first and fifth defendants have given notice of intention to defend.

2. The relevant parts of O.15, r.12A of the Grand Court Rules provide as follows:

"(1) This rule applies to every action begun by writ by one or more shareholders of a company where the cause of action is vested in the company and relief is accordingly sought on its behalf (referred to in this rule as a 'derivative action').

(2) Where a defendant in a derivative action has given notice of intention to defend, the plaintiff must apply to the Court for leave to continue the action.

(3) The application must be supported by an affidavit verifying the facts on which the claim and the entitlement to sue on behalf of the company are based."

The rule then makes various provisions concerning service and other procedural matters and continues:

"(8) On the hearing of the application under paragraph (2), the Court may—

(a) grant leave to continue the action, for such period and upon such terms as the Court may think fit;

(b) subject to paragraph (11) [which makes provision for when only part of the relief claimed is sought on behalf of the company], dismiss the action;

(c) adjourn the application and give such direction as to joinder of parties, the filing of further evidence, discovery, cross examination of deponents and otherwise as it may consider expedient."

After making certain further provisions the rule continues:

"(13) The plaintiff may include in an application under paragraph (2) an application for an indemnity out of the assets of the company in respect of costs incurred or to be incurred in the action and the Court may grant such indemnity upon such terms as may in the circumstances be appropriate."

3. The plaintiff's application for leave to continue the action is strongly opposed by the first and fifth defendants and several issues arise for determination. First, there is the question of the test which the court should adopt in considering whether to grant leave to the plaintiff in a derivative action to continue the action. Secondly, there is the issue of whether on the material before the court the plaintiff has met that test. Thirdly, there is the question whether a derivative action may be brought by a shareholder in the holding company of the company (or in this case the exempted limited partnership) which is its ultimate subsidiary and in which, at least arguably, the cause of action against the defendant(s) is vested. Such an action is usually described as a multiple derivative action. There is also a question as to whether such a shareholder in a holding company may claim for loss or damage which, having arguably been sustained by a subsidiary company, is reflective loss. These are the principal issues arising in this matter but there are other peripheral issues as well.

The derivative action

4. The concept of a derivative action is well-established in this jurisdiction, as in other Commonwealth jurisdictions. In the leading judgment of the Court of Appeal in *Schultz v. Reynolds (11)*, Zacca, P. referred to the well-known English authorities which he clearly accepted as reflecting

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also the law of the Cayman Islands. He started with the general principle established in *Foss* v. *Harbottle* (6) which is (*1992–93 CILR at 63*)—

"that where a wrong has been done to a company, *prima facie* the only proper plaintiff is the company itself and that an action by a shareholder claiming relief for the company is not available. The plaintiff may only bring a derivate action if it falls within the exceptions to the rule in *Foss* v. *Harbottle.*"

That the concept of a derivative action is an exception to that principle is explained in the judgments in *Edwards* v. *Halliwell* (5), *Wallersteiner* v. *Moir (No. 2)* (16) and *Prudential Assur. Co. Ltd.* v. *Newman Indus. Ltd. (No. 2)* (10). The President referred to the judgment of Jenkins, L.J. in *Edwards* v. *Halliwell*, where he said ([1950] 2 All E.R. at 1067):

"It has been further pointed out that where what has been done amounts to what is generally called in these cases a fraud on the minority and the wrongdoers are themselves in control of the company, the rule is relaxed in favour of the aggrieved minority who are allowed to bring what is known as a minority shareholders' action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue. Those exceptions are not directly in point in this case, but they show, especially the last one, that the rule is not an inflexible rule and that it will be relaxed where necessary in the interests of justice."

5. In *Wallersteiner* v. *Moir (No. 2)* (16), Lord Denning, M.R. clearly explained why a derivative action should be available when a company is controlled by the alleged wrongdoers ([1975] Q.B. at 390):

"But suppose [the company] is defrauded by insiders who control its affairs—by directors who hold a majority of the shares—who then can sue for damages? Those directors are themselves the wrongdoers. If a board meeting is held, they will not authorise the proceedings to be taken by the company against themselves. If a general meeting is called, they will vote down any suggestion that the company should sue them themselves. Yet the company is the one person who is damnified. It is the one person who should sue. In one way or another some means must be found for the company to sue. Otherwise the law would fail in its purpose. Injustice would be done without redress."

6. He also said in a passage also cited by the President (*ibid.*, at *391*):

"Stripped of mere procedure, the principle is that, where the wrongdoers themselves control the company, an action can be brought on

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behalf of the company by the minority shareholders on the footing that they are its representatives to obtain redress on its behalf.

I am glad to find this principle well stated by Professor Gower in *Modern Company Law*, 3rd ed. (1969), at 587, in words which I would gratefully adopt:

'Where such an action is allowed, the member is not really suing on his own behalf nor on behalf of the members generally, but on behalf of the company itself. Although . . . he will have to frame his action as a representative one on behalf of himself and all the members other than the wrongdoers, this gives a misleading impression of what really occurs. The plaintiff shareholder is not acting as a representative of the other shareholders, but as a representative of the company . . . In the United States . . . this type of action has been given the distinctive name of a "derivative action," recognising that its true nature is that the individual member sues on behalf of the company to enforce rights derived from it.'"

The test which the court should apply

7. The requirement that the plaintiff in a derivative action in which the defendant has given notice of intention to defend must apply to the court for leave to continue the action was introduced in the Grand Court Rules of 1995. It had previously been introduced in England in the Rules of the Supreme Court, then in the Civil Procedure Rules and is apparently now in the Companies Act 2006. The reason for its introduction was to provide a safeguard to prevent vexatious or inappropriate claims, which were not in the interests of the company concerned to pursue. Prior to the introduction of the requirement in the Rules for the plaintiff to obtain leave to continue, a defendant's only recourse was to apply to strike out the action or to have the plaintiff's entitlement to bring the derivative action determined as a preliminary issue.

8. There is, however, little reported guidance as to the test which the court should apply in determining whether the plaintiff should have leave to continue the action. There is no reported authority in this jurisdiction. (*Schultz v. Reynolds (11)* was before the rule was introduced and in any event the issue in that case was whether the plaintiff as beneficial owner rather than legal owner of shares in the company could bring a derivative action.)

9. However, in England, prior to the introduction of the equivalent of O.15, r.12A of the Grand Court Rules, at common law the plaintiff was required to satisfy the court that he had a *prima facie* case in order to justify proceeding with such a claim. In fact, there are two elements to this: first, the plaintiff was required to show *prima facie* that there was a

viable cause of action vested in the company and, secondly, that the alleged wrongdoers had control of the company (or could block any resolution of the company or the board) and thereby prevent the company bringing an action against themselves.

10. In *Prudential Assur. Co. Ltd.* v. *Newman Indus. Ltd. (No. 2)* (10), the English Court of Appeal said ([1982] Ch. at 221):

"In our view, whatever may be the properly defined boundaries of the exception to the rule [in *Foss* v. *Harbottle*], the plaintiff ought at least to be required before proceeding with his action to establish a *prima facie* case (i) that the company is entitled to the relief claimed, and (ii) that the action falls within the proper boundaries of the exception to the rule in *Foss* v. *Harbottle.* On the latter issue it may well be right for the judge trying the preliminary issue 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."

11. With regard to the latter comment, in the present case there would, in my opinion, be no point in adjourning to enable a meeting of shareholders of the company. This is because the first defendant controls 50% of the shares in the company and is one of only two directors of the company, so the outcome of such a meeting would be a foregone conclusion.

12. Since the procedural rule requiring the plaintiff in a derivative action to obtain leave has been introduced, it has apparently continued to be the position of the English courts that a plaintiff in seeking leave to continue should satisfy the court that he has a *prima facie* case in relation both to the merits of the claim by the company and, secondly, that the alleged wrongdoing has been perpetrated by the majority who are in control or are otherwise in a position to prevent the company from pursuing the claim against them. In my opinion, in the present case, if the company has a *prima facie* viable claim against the first defendant as one of its directors (which I have yet to consider), the case falls within the exception to the rule in *Foss* v. *Harbottle* (6) because, as I have already explained, the first defendant is clearly in a position to prevent the company from bringing such a claim against him. The question, therefore, in the present case is whether the company has a *prima facie* claim against the first and fifth defendants.

The independent board test

13. However, it was argued on behalf of the first and fifth defendants that there are two limbs to the test which the plaintiff in a derivative action must satisfy in seeking leave to continue. It was submitted that not only must the plaintiff satisfy the court that the company has a *prima facie* case against the defendant on its merits but he must also satisfy the court that, even if the company does have such a case, a hypothetical independent

board of the company acting reasonably would have brought and proceeded with the case.

14. This submission was largely based on the comments of the judge (Warren, J.) in *Airey* v. *Cordell* (1). That case concerned an application by a minority shareholder in a company to carry on a claim as a derivative action in relation to alleged breaches of duty by the directors in diverting a corporate opportunity of the company in which he was a shareholder to a new company owned by them in which he was neither a shareholder nor a director. The defendant directors accepted that there was a *prima facie* case against them and that the case was in principle within the exception to the rule in *Foss* v. *Harbottle* (6) to enable a derivative claim. However, they argued that the test to be applied by the court in deciding whether to allow a derivative claim to continue was based on what a reasonable, independent board of directors would do and they contended that an independent board would not have sued the directors but would have waited for developments and, if the corporate opportunity concerned was successful, then sued for an account of profits.

15. In his judgment, the judge set out the background to the case in some detail, in particular the various proposals by the defendant directors pursuant to which, they argued, the claimant would be allowed to share in the profits derived from exploiting the corporate opportunity. They contended this was the real complaint of the complainant rather than that the company itself was being deprived of such benefit. As the judge commented, as a matter of legal analysis, the way in which the complainant shareholder conceived that he could share in the benefit of the corporate opportunity was to make sure that it was retained by the company in which he was a shareholder and its subsidiary, an analysis which, as will be seen, is not wholly dissimilar from that in the present case.

16. Having reviewed *Wallersteiner* v. *Moir (No. 2)* (16) and *Prudential Assur. Co. Ltd.* v. *Newman Indus. Ltd. (No. 2)* (10), the judge said ([2007] BCC 785, at para. 55):

"As I said, it is a minimum of a *prima facie* case in relation to (i) and (ii) so the case may clearly be within the exception to *Foss* v. *Harbottle*, for instance because, if there is a breach of duty, it is clearly one perpetrated by the majority who are in control, but there may nonetheless be a very weak case on the part of the company itself if it brought proceedings, so that if it did not even amount to a *prima facie* case the derivative proceedings would not be allowed to continue."

17. As I have already said, it is my view that the present case does fall within the exception to *Foss* v. *Harbottle* (6) and I did not understand counsel for the parties to argue otherwise. However, the judge in *Airey* v. *Cordell* (1) then went on to refer to the comments of the judge in *Smith* v.

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Croft (12), which was an application in a derivative action for an indemnity by the company of the plaintiff shareholder's costs of the action down to discovery. The judge in that case, Walton, J., said ([1986] 1 W.L.R. at 590):

"Of course there is no room for a mini trial, of course the court has no ability at this stage to decide the truth of the plaintiffs' allegations. What, however, it can and should do is to look at all the facts, first those which are common ground, then those alleged by the plaintiff but denied by the company, and then those alleged by the company but denied by the plaintiff, and make up its mind. The standard suggested by Buckley, L.J. in *Wallersteiner* v. *Moir (No. 2)* was that of an independent board of directors exercising the standard of care which prudent businessmen would exercise in their own affairs. Would such an independent board consider that it ought to bring the action?"

18. As the judge in *Airey* v. *Cordell* (1) emphasized, that was said in relation to an application for an indemnity against costs and not in relation to an application to strike out the derivative action. Nonetheless, after considering *Mumbray* v. *Lapper* (8), he concluded as follows ([2007] BCC 785, at paras. 75–76):

"My conclusion in agreement with Judge Reid is that the appropriate test for bringing proceedings is indeed the view of the hypothetical independent board of directors, but I am also of the view that it is not for the court to assert its own view of what it would do if it were the board, but it merely has to be satisfied that a reasonable board of directors could take the decision that the minority shareholder applying for permission to proceed would like it to take, and I do not think it would be right to shut out the minority shareholder on the basis of the court's, perhaps inadequate, assessment of what it would do rather than a test which is easier to apply, which is whether any reasonable board could take that decision.

If no reasonable board would bring the proceedings, even though there is a *prima facie* case, then the court should not sanction the minority shareholder's action. This may mean that the introduction of a requirement for permission first in the RSC and now in CPR, has narrowed the range of cases which can now be brought compared with the minimum standard that the *Prudential* case might appear to have laid down and the sort of case which it at least seems possible but Buckley, L.J. seems to think might have been permitted to continue, not with the sanction of the court but simply to continue at the decision of the minority shareholder at his own risk as to costs."

19. The judge's decision on the facts of that case was that it could not be said that no reasonable board would not pursue the directors by litigation.

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However, he went on to stay the action to allow the parties to attempt to agree a detailed proposal whereby the claimant shareholder would be given an interest under the directors' new arrangements which would adequately reflect his interest in the company and its subsidiary.

20. With due respect, it does not seem to me that the conclusion of the judge in *Airey* v. *Cordell* (1) that the test for approving the continuance of a derivative claim is the view of the hypothetical independent board of directors is appropriate and in my opinion it does not represent the law in this country. The basis for the judge's view is that he considers that the test to be applied in considering whether a shareholder may continue a derivative action and the test to be applied in considering whether a shareholder should have an indemnity from the company for his costs of such an action should be the same. His analysis relies on comments by Buckley, L.J. in *Wallersteiner* v. *Moir (No. 2)* (16), which was itself a case concerning *inter alia* an application for an indemnity of the shareholder's costs by the company, when he said, by analogy with the position in a *Beddoe* (3) application by a trustee (which is, of course, an application for indemnity for costs out of the trust fund) ([1975] Q.B. at 403):

"In all the instances mentioned the right of the party seeking indemnity to be indemnified must depend on whether he has acted reasonably in bringing or defending the action, as the case may be: see, for example, as regards a trustee, *In re Beddoe.* It is true that this right of a trustee, as well as that of an agent, has been treated as founded in contract. It would, I think, be difficult to imply a contract of indemnity between a company and one of its members. Nevertheless, where a shareholder has in good faith and on reasonable grounds sued as plaintiff in a minority shareholder's action, the benefit of which, if successful, will accrue to the company and only indirectly to the plaintiff as a member of the company, and which it would have been reasonable for an independent board of directors to bring in the company's name, it would, I think, clearly be a proper exercise of judicial discretion to order the company to pay the plaintiff's costs. This would extend to the plaintiff's costs down to judgment, if it would have been reasonable for an independent board exercising the standard of care which a prudent business man would exercise in his own affairs to continue the action to judgment. If, however, an independent board exercising that standard of care would have discontinued the action at an earlier stage, it is probable that the plaintiff should only be awarded his costs against the company down to that stage."

21. Buckley, L.J. then went on to propose a procedure (this was, of course, before the rule in England, from which O.15, r.12A(2) of the Grand Court Rules is derived, came into effect) analogous to the procedure adopted by a trustee pursuant to *In re Beddoe* (3) by way of an *ex*

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parte application at which the merits of the case may be discussed with the court and the court, if it considers it appropriate, may give directions as to whether the company or other minority shareholder or the defendants or anyone else should be made respondents to the application.

22. However, in the context of derivative proceedings all of this clearly related to an application by the plaintiff shareholder for an indemnity for his costs of the action from the company. It did not concern directly the appropriate test which the court should adopt in considering whether the plaintiff should have leave to commence or continue the action. In fact what Buckley, L.J. said about that in the passage to which I have referred was (*ibid.*) "where a shareholder has in good faith and on reasonable grounds sued as plaintiff in a minority shareholder's action" which suggests he considered that the appropriate circumstances were when the minority shareholder sued in good faith and on reasonable grounds.

23. It seems to me that "reasonable grounds" is very similar to a *prima facie* case. The test for bringing or continuing derivative action was first specifically considered and explained in *Prudential Assur. Co. Ltd.* v. *Newman Indus. Ltd. (No. 2)* (10) some six years later when, in the passage from the English Court of Appeal judgment to which I have already referred, the court gave their view that the plaintiff in a derivative action ought at least be required before proceeding to establish a *prima facie* case that the company is entitled to the relief claimed and that the action falls within the exception to the rule in *Foss* v. *Harbottle* (6).

24. In the present case, there was and is no application by the plaintiff for an indemnity for its costs of the action by the company and I was informed that it is not intended to make one. Accordingly, the issue in *Wallersteiner* v. *Moir (No. 2)* (16), on which the judge in *Airey* v. *Cordell* (1) relied, does not arise. The conclusion of the judge in *Airey* v. *Cordell* is apparently derived from the case of *Mumbray* v. *Lapper* (8) in which the judge in that case, having considered the relevance of the shareholder claimant's conduct and of the availability of an alternative remedy, stated ([2005] BCC 990, at para. 5): "The central question in any case such as this is 'Would an independent board sanction pursuit of the proceedings?'"

25. I was referred by counsel for the plaintiff to the judgments of the Court of Final Appeal of Hong Kong in *Waddington Ltd.* v. *Chan Chun Hoo* (15). In his judgment, Ribeiro, P.J. said ([2008] HKEC 1498, at para. 13):

"The derivative action is a procedural device invented by the courts to afford protection to the minority. Procedurally, there is no requirement at common law for a person seeking to sue derivatively first to obtain leave of the court. But it does not follow from this that there is no threshold requirement to be met by the plaintiff. Substantively, such an action is only permitted where it can *prima facie* be shown

that there exists a viable cause of action or equitable claim vested in the company which, if made good, would establish a fraud on the minority; as well as control of the company by the alleged wrongdoers such as to enable them to stifle any proposed action against themselves."

26. Having explained the procedural practice at common law he went on to say (*ibid.*, at *para. 14*): "It is in such a context that the court has to consider whether the self-appointed derivative plaintiff should be permitted to proceed with the action by way of exception to the proper plaintiff rule."

27. He then referred to *Prudential Assur. Co. Ltd.* v. *Newman Indus. Ltd. (No. 2)* (10) and the conclusion of that court which he summarized as (*ibid.*, at *para. 16*) "the answer was for a *prima facie* case test to be adopted, coupled with the possibility of seeking the views of the company in general meeting where appropriate." Having referred also to *Smith* v. *Croft* (12), he said (*ibid.*, at *para. 17*) "this has continued to be the approach of the English courts," and referred in a footnote to, amongst other cases, *Airey* v. *Cordell* (1).

28. After explaining that the *prima facie* test has also been adopted in Hong Kong, Ribeiro, P.J. continued (*ibid.*, at *para. 20*):

"The common law rule is therefore that a plaintiff whose standing to bring a derivative action is challenged must establish a *prima facie* case that the company is entitled to the relief claimed and that the action falls within an applicable exception to the rule in *Foss* v. *Harbottle* (usually the fraud on the minority exception). Where, as often occurs, the plaintiff seeks an order to be indemnified as to costs by the company which may benefit from the derivative action, the court's approach is to consider whether and to what extent an honest, independent and prudent board might decide to authorise prosecution of the action, given the available evidence."

And he referred as support for his comments again to *Airey* v. *Cordell* as well as *Wallersteiner* v. *Moir (No. 2)* (16) and *Smith* v. *Croft.*

29. In the same case, Lord Millett, N.P.J. said (*ibid.*, at *paras. 53–54*):

"The solution which the Court of Appeal found in *Prudential* was to require the plaintiff, whether at the trial of a preliminary issue or on an application to strike out the proceedings, to establish a *prima facie* case both that the company was entitled to the relief claimed and that the plaintiff was entitled to bring the claim on its behalf by way of a derivative action. In an appropriate case the court could adjourn the proceedings in order to ascertain whether the independent shareholders considered that it was in the interests of the company to pursue the claim.

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This approach was followed in *Smith* v. *Croft (No. 2)* and was subsequently adopted by the Rules Committee when the Rules of the Supreme Court were amended by adding O.15, r.12A (later CPR r.19.9 and now s.260 of the Companies Act 2006). This imposed a requirement for the plaintiff in a derivative action to obtain the leave of the court to continue the action, thereby providing the filter which had been discarded more than a century earlier. The plaintiff has consistently been required on the application for leave to establish a *prima facie* case both that the company would be likely to succeed if it brought the action itself and that the case falls within an exception to the rule in *Foss* v. *Harbottle*."

30. I respectfully agree with the statements of Ribeiro, P.J. and Lord Millett, N.P.J. It does not in my view follow, as suggested in *Airey* v. *Cordell* (1), that the test to be adopted in considering whether a shareholder should have leave to proceed with a derivative action and the test to be adopted in considering whether a shareholder plaintiff in a derivative action should have an indemnity for his costs from the company should necessarily be the same. The circumstances and the considerations seem to me to be different. In an application for leave to continue a derivative action there are not inevitably financial consequences for the company.

31. The only issue is, or should be, whether there is a *prima facie* case, first, that the claim falls within the exception to the rule in *Foss* v. *Harbottle* (6) and, secondly, on the merits against the defendant. The purpose of this "filter," as Lord Millett, N.P.J. described it, is to satisfy the court that there are reasonable grounds for the plaintiff's claim and that it is not vexatious or frivolous or has no real prospect of success. In an application for an indemnity for costs by the company there are obviously potential financial consequences for the company. One can see that in such circumstances consideration of whether a hypothetical independent board of directors would be likely to approve the incurring of such costs would be appropriate in determining that issue. But where the only issue is whether the plaintiff should have leave to continue the action there is no risk to the company and, in my view, no need to be concerned with the views of a hypothetical board.

32. In my opinion, the appropriate test for this court to adopt in considering an application for leave to continue a derivative action is the *prima facie* case test, that is, where a defendant in a derivative action has given notice of intention to defend, the plaintiff must satisfy the court that the company has a *prima fac*ie case against the defendant (and that the action falls within an applicable exception to the rule in *Foss* v. *Harbottle* (6)). Even if I am wrong about this, there was anyway no evidence before me to indicate that a hypothetical honest, independent and prudent board of directors could or would not have proceeded with the claim of the company, if such a board was satisfied that there was a *prima facie* case. I

propose to consider the plaintiff's application on the basis of the *prima facie* case test.

Standard of a *prima facie* case

33. There does not appear to have been any precise analysis in the English case law of the standard of a *prima facie* case in this context. In *Prudential Assur. Co. Ltd.* v. *Newman Indus. Ltd. (No. 2)* (10), in the passage which I have already quoted, it was made clear that the right to progress a minority action is not to be equated with the absence of grounds for a strike-out in ordinary litigation. It has also been made clear that a *prima facie* case is more than a good arguable case. It is also clear that the hearing of such an application for leave "must not be allowed to turn into a mini-trial, but the Court must nevertheless have sufficient evidence before it is able to make a careful assessment of the merits"—see 1 *Supreme Court Practice 1999*, para. 15/12A/4, at 259.

34. Counsel for the plaintiff accepted that the plaintiff must do more than merely show that the case cannot be struck out but he also submitted that the plaintiff does not have to prove its case on the evidence as if this were a trial, which in my view must be right. However, he also argued that the appropriate question is whether, if the defendants were to choose not to defend, the claim would be more likely than not to succeed on the pleaded case and the material before the court. That seems to me to amount to submitting in effect that the court should proceed as if the pleaded case were true and ignore the evidence submitted by the defendants, which does not accord with my understanding of the authorities.

35. The purpose of requiring the plaintiff to obtain leave to continue the derivative action, as I understand it, is to prevent the expense and time of (and to protect the defendants against) vexatious or unfounded litigation which has little or no prospect of success or which is clearly brought by an aggrieved shareholder for his own reasons rather than in the interests of the company. The phrase "*prima facie*" has various shades of meaning but literally means "at first sight." Given that there is not to be a mini-trial of the plaintiff's case, it seems to me that I must form a view of the plaintiff's case based on my first impressions, having regard to my assessment of all the evidence before me, including that submitted by the defendants. For the plaintiff to obtain leave to continue with the action, I consider that I must be satisfied in the exercise of my discretion that its case is not spurious or unfounded, that it is a serious as opposed to a speculative case, that it is a case brought *bona fide* on reasonable grounds, on behalf of and in the interests of the company and that it is sufficiently strong to justify granting leave for the action to continue rather than dismissing it at this preliminary stage.

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The parties

36. The plaintiff, Renova Resources Private Equity Ltd., is a company incorporated in the Bahamas. It is wholly owned by Renova Holding Ltd., ("Renova Holding") which is a Bahamian holding company and a member of the Renova Group of companies ("the Renova Group"). The Renova Group is ultimately controlled by Mr. Viktor Vekselberg. The plaintiff is the holder of 50% of the shares in the second defendant company, Pallinghurst (Cayman) General Partner LP (GP) Ltd. ("the company"). It is on behalf of the company that the plaintiff purports to bring this derivative action. The company is incorporated in the Cayman Islands. The holder of the other 50% of the shares in the company is Fairbairn Trust Ltd., which is effectively controlled by the first defendant, Mr. Brian Gilbertson. There are two directors of the company, Mr. Gilbertson and Mr. Vladimir Kuznetsov who is the investment director of another member company of the Renova Group.

37. The company is the general partner of a Cayman exempted limited partnership called Pallinghurst (Cayman) General Partner LP ("GPLP"), the third defendant. GPLP is in turn the general partner of the fourth defendant, another Cayman exempted limited partnership called Pallinghurst Resources Management LP ("the master fund"). The fifth defendant ("Autumn") is a British Virgin Islands company also wholly owned by Fairbairn Trust Ltd. and therefore a Gilbertson entity.

38. This structure was established pursuant to an agreement between Renova Holding and Mr. Gilbertson contained in a letter dated November 24th, 2005 ("the letter agreement"). Mr. Gilbertson was employed by a Renova Group entity in Russia and the preamble to the letter agreement states that it sets out conditions relating to the granting by Renova Holding of certain "incentive units," being notional shares in another Renova Group company, to Mr. Gilbertson. Pursuant to the letter agreement, Renova Holding was to set up, and duly did set up, the structure at its cost and Renova Holding and Mr. Gilbertson were to work together to add value to the master fund. The purpose of the master fund was to explore, acquire and develop opportunities in the metal and mining industry. As can be seen, the structure involved the setting up of the master fund, GPLP and the company, with the company as the general partner of GPLP and, through it, ultimately the master fund. This structure was known throughout as the Pallinghurst structure.

[The learned judge outlined the duties of Mr. Gilbertson towards the master fund and the company as detailed in the letter agreement and continued:]

The plaintiff's case

39. The complaint which the plaintiff seeks to bring on behalf of the company by way of the derivative action is that Mr. Gilbertson, who was

at all material times a director of the company, acted in breach of his fiduciary duties to the company by diverting away from the company a valuable opportunity to acquire from Unilever Plc. the benefit of exploiting the rights to the Fabergé brand ("the rights"). This opportunity to acquire and exploit the rights became known as "Project Egg."

40. The plaintiff also alleges that Autumn (which is a family entity of Mr. Gilbertson's) participated in this diversion of assets by, unknown to the company, providing part of the funding for the purchase of the rights and acquiring substantial shares in the company which acquired the rights, Project Egg Ltd. ("PEL"), in consideration for such funding. The plaintiff contends that Autumn made this investment and received shares in PEL, knowing that the dilution of the master fund's 100% ownership of PEL and the issue of new shares in PEL, *inter alia* to Autumn, was a breach of fiduciary duty by Mr. Gilbertson and that consequently Autumn received its shares in PEL as a constructive trustee for the master fund and the Pallinghurst structure.

41. The plaintiff pleads that, as a director of the company, Mr. Gilbertson owed fiduciary duties to the company, including the duties to act in good faith, in the best interests of the company, not to place himself in a position where his duties to the company and his own interests might conflict and to refrain from self-dealing. The plaintiff also contends that Mr. Gilbertson's actions amounted to making a secret profit and that he had a duty to account for such profit. The plaintiff pleads that Mr. Gilbertson is in breach of all of these duties and that, as explained above, Autumn is also liable to account as a constructive trustee.

[The court summarized the reliefs sought by the plaintiff and then noted the affidavits and documentation it had received in support of and in opposition to the application. The learned judge continued:]

The history of the dispute

[The learned judge outlined the background to the acquisition of the rights, and in particular the dispute as to whether it was ever intended that they should be acquired within the investment structure and consequently whether Mr. Gilbertson owed any fiduciary obligations in respect of the transaction. He continued:]

Conduct of the plaintiff

42. Mr. Gilbertson also contends that the conduct of the Renova Group renders it inequitable to grant leave to the plaintiff, a member of that group, to continue these proceedings. As explained above, Mr. Gilbertson argues that the position taken by the plaintiff in these proceedings (that Mr. Gilbertson diverted the rights away from the Pallinghurst structure) is inconsistent with the position taken by Renova Holding in 2007, and

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particularly in its letter of May 25th, 2007. He says that this *volte face* demonstrates that the plaintiff has not brought this action *bona fide* for the benefit of the company or the Pallinghurst structure.

43. It is said also on behalf of Mr. Gilbertson that the conduct of Mr. Vekselberg as the ultimate principal of the Renova Group and thus of the plaintiff, in seeking to procure the transfer of the ownership of the rights outside the Pallinghurst structure, itself resulted in breaches of duty to the company by Mr. Kuznetsov, Mr. Gilbertson's fellow director. It was contended that it was Mr. Kuznetsov who acted in breach of his fiduciary duties to the company by pursuing Mr. Vekselberg's personal agenda rather than the best interests of the company and the Pallinghurst structure. It was submitted that the Renova Group have been the authors of their own misfortune by insisting that the rights should be owned outside the Pallinghurst structure and that a court of equity should not assist a party who has brought about the very matters complained about.

44. In *Nurcombe* v. *Nurcombe* (9), Browne-Wilkinson, L.J. said, by reference to *Towers* v. *African Tug Co.* (13) ([1985] 1 W.L.R. at 378):

"In my judgment, that case established that behaviour by the minority shareholder, which, in the eyes of equity, would render it unjust to allow a claim brought by the company at his instance to succeed, provides a defence to a minority shareholder's action. In practice, this means that equitable defences which would have been open to defendants in an action brought by the minority shareholder personally (if the cause of action had been vested in him) would also provide a defence to those defendants in a minority shareholder's action brought by him."

The defendant argues this conduct by the plaintiff shareholder or those behind it renders it inequitable to allow a claim brought by it on behalf of the company to proceed.

45. The plaintiff argues that the contentions on behalf of Mr. Gilbertson are a misinterpretation of the facts and that it was always intended by the plaintiff and the Renova Group that the economic benefit and management of the rights should remain within the Pallinghurst structure and that it was the actions of Mr. Gilbertson which diverted that economic benefit and control away from the Pallinghurst structure, and thus the company, in breach of his duties to the company. What is more, the plaintiff says, the Gilbertsons clearly initially agreed with this proposal and entered into negotiations about the precise terms of a draft agreement giving effect to it. There was no suggestion by them at the time that it was not in the best interests of the Pallinghurst structure or of the company, or that Mr. Gilbertson was somehow released from his duties as a director of the company as a result. Indeed, there was nothing to indicate, until Mr.

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Gilbertson's email of January 2nd, 2007, that everything was not proceeding on this basis and that the Pallinghurst structure, with the company at its head, would not shortly be the owner of the economic benefit and the manager of the rights.

46. The plaintiff contends that Mr. Gilbertson's real intention from a much earlier stage was to acquire the rights himself and, as he said himself in an email, to "warehouse" them with a view to then negotiating about the possible return of the rights to the Pallinghurst structure from a position of strength. As far as the letter of May 25th, 2007 is concerned, the plaintiff argued that it is simply not relevant in determining the true position which must be derived from the contemporary communications documentation and actions of the parties and not *ex post facto* at a time when the Renova Group were negotiating months later to resolve a situation caused by Mr. Gilbertson's breaches of duty. The plaintiff contends that the letter does not provide an equitable defence to Mr. Gilbertson of the kind envisaged in *Nurcombe* (9) and that what matters is the conduct of the parties at the relevant time. The plaintiff says the case it pleads represents its position as it was at the material time.

47. In my view, the letter of May 25th, 2007, and indeed, the comments of Renova Holding in March 2007, while no doubt material for cross-examination if the case were to proceed, do not constitute conduct of a kind which, at least at this stage and for this purpose, sufficiently impacts on the *bona fides* and equity of the plaintiff's case such as to satisfy me that in the light of it the plaintiff should not have leave to continue the action.

Mr. Gilbertson's duties

48. Counsel for Mr. Gilbertson argued that the letter agreement was fundamental to the relationship between Mr. Gilbertson and the Renova Group and that this determined the scope of Mr. Gilbertson's fiduciary duties. Mr. Gilbertson argues that from an early stage it was envisaged that the rights would be an investment of the Pallinghurst structure pursuant to the letter agreement, but that it was the Renova Group who changed this by their insistence that the rights should be owned by another Renova company, Lamesa. At that point, it is argued, Mr. Gilbertson would have been perfectly entitled to say "No" to that proposal and he had no duty to negotiate an alternative. It was not his duty, it is said, to serve Mr. Vekselberg's interests. In fact, Mr. Gilbertson did attempt to reach an accommodation with Mr. Vekselberg in his personal capacity but it was submitted that at that point he was acting as an investor for commercial reasons and not in his capacity as a director of the company. Mr. Gilbertson contends that latterly the draft agreement proposed by the Renova Group for the new arrangement sought to place restrictions on any future sale by PEL of the economic benefit of the rights, which would have made it difficult if not impossible for the master fund to realize the

investment. In the circumstances, there could be no breach of Mr. Gilbertson's duties to the company and there was none.

49. The plaintiff, on the other hand, argues that Mr. Gilbertson had clear duties to the company as a director to act in the best interests of the company, to act *bona fide* and honestly and not to place himself in a position where his own interests conflicted with those of the company or to make a profit at the expense of the company. The plaintiff contends that from December 20th, 2006 it was clear that the Pallinghurst structure would retain the economic benefit and control of the rights and that Mr. Gilbertson agreed in principle with that. It remained his duty, in the best interests of the company, to ensure that was achieved and not to divert that commercial opportunity to himself. By diverting the economic benefit of the rights away from the company and its subsidiary entities in the Pallinghurst structure, Mr. Gilbertson, it is argued, clearly breached his duties to the company for his own personal benefit. It is argued that the terms on which the Renova Group would procure the funding of the purchase of the rights were perfectly reasonable and in the best interests of the company, even if not acceptable to Mr. Gilbertson personally.

50. Although, there are clearly arguable defences to the claim which the plaintiff makes on behalf of the company and its subsidiary entities against Mr. Gilbertson for breach of his duties as a director of the company, I am satisfied that the plaintiff has a *prima facie* case against Mr. Gilbertson for breach of his duties as a director. The commercial opportunity of acquiring the economic benefit and control of the rights, while it may not have involved retaining actual title to the rights as originally contemplated, nonetheless remained a valuable commercial opportunity which it would have been in the interests of the company to acquire. *Prima facie* the diversion of that opportunity away from the company and its subsidiary entities in the Pallinghurst structure by a director of the company for his own personal benefit would be a breach of that director's duties to the company. My overall assessment of the totality of the affidavit evidence put before me at the hearing in my view supported that *prima facie* analysis.

Indemnities and exclusions in articles of association

51. Apart from his arguments as summarized above, Mr. Gilbertson also claims that as a director of the company he has the benefit of indemnities and exclusions contained in the articles of association of the company which exonerate him from liability in respect of any breach of fiduciary duty on his part and preclude any claim against him in respect of such alleged liability. The relevant articles are 131 and 132 which read as follows:

"131. Every director (including for the purposes of this article any alternate director appointed pursuant to the provisions of these

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articles), secretary, assistant secretary, or other officer for the time being and from time to time of the company (but not including the company's auditors) and the personal representatives of the same shall be indemnified and secured harmless out of the assets and funds of the company against all actions, proceedings, costs, charges, expenses, losses, damages or liabilities incurred or sustained by him in or about the conduct of the company's business or affairs or in the execution or discharge of his duties, powers, authorities or discretions, including without prejudice to the generality of the foregoing, any costs, expenses, losses or liabilities incurred by him in defending (whether successfully or otherwise) any civil proceedings concerning the company or its affairs in any court whether in the Cayman Islands or elsewhere.

132. No such director, alternate director, secretary, assistant secretary or other officer of the company (but not including the company's auditors) shall be liable (a) for the acts, receipts, neglects, defaults or omissions of any other such director or officer or agent of the company or (b) for any loss on account of defect of title to any property of the company or (c) on account of the insufficiency of any security in or upon which any money of the company shall be invested or (d) for any loss incurred through any bank, broker or other similar person or (e) for any loss occasioned by any negligence, default, breach of duty, breach of trust, error of judgment or oversight on his part or (f) for any loss, damage or misfortune whatsoever which may happen in or arise from the execution or discharge of the duties, powers, authorities, or discretions of his office or in relation thereto, unless the same shall happen through his own dishonesty."

52. Mr. Gilbertson contends that these articles exonerate him as a director and that on the plaintiff's case it cannot be said that he was not acting in or about the business of the company at the relevant time. Reference was made to the decision of the Privy Council in *Viscount of Royal Ct.* v. *Shelton* (14) when the articles of a company incorporated in Jersey, which were in very similar terms, were considered. The Judicial Committee held that the relevant article was to be construed as exonerating a director from personal liability, even where his actions had resulted in an act *ultra vires* of the company. The article concerned concluded with the same words as art. 132 of the company in the present case: "unless the same shall happen through his own dishonesty." Although those words do not appear to qualify art. 131, it was accepted on behalf of Mr. Gilbertson that the two articles should be read together and that the reference to dishonesty impliedly qualified art. 131 as well. However, it was submitted that the plaintiff has not pleaded dishonesty in the present case. While acknowledging that the position with respect to the plaintiff's claim against Autumn is clearly different, it was argued nonetheless that since

the claim against Autumn is dependent upon the claim against Mr. Gilbertson, if there is no cause of action against Mr. Gilbertson there can be no cause of action against Autumn.

53. The interpretation and consequences of similar articles were considered in this court by Smellie, C.J. in *In re Bristol Fund Ltd. (4)*. In his judgment, the Chief Justice stated (*2008 CILR 317, at paras. 70–71*):

"70 . . . At this stage, the only guidance I think I can possibly give is that the liquidators should not need to provide for amounts of damages to which EYCI may become liable based on its 'wilful default or wilful neglect, fraud or dishonesty,' as such liabilities are excluded, either expressly (as in the case of the indemnity within BHM's articles) or implicitly, because of the nature of what has been termed in another context the 'irreducible core' of a fiduciary's obligations; that is the duty to always act in honesty and good faith (see *Armitage* v. *Nurse*). These irreducible core obligations would remain, despite the terms of any indemnity, whether given under the audit engagement letters or under Bristol's articles.

71 This is a longstanding principle in English company law: see *In re City Equitable Fire Ins. Co.* ([1925] 1 Ch. at 441) following *In re Brazilian Rubber Plantations & Estates Ltd.* ([1911] 1 Ch. at 440) (*per* Romer, J., upheld on appeal to the Court of Appeal). It is a principle which has long since been codified in English company legislation and, by virtue of that codification, it is not possible to give so wide an indemnity as to exclude liability for fraud, dishonesty or wilful default on the part of officers who owe fiduciary obligations to companies . . . Liability found against EYCI, based on allegations of simple negligence, may, however, be covered by the indemnities, as would any further legal costs incurred by EYCI in successfully defending against any kind of claim covered by the indemnities."

54. It was argued on behalf of Mr. Gilbertson that the Chief Justice's reference to *Armitage* v. *Nurse* (2), in support of his reference to the "irreducible core" of a fiduciary's obligations which cannot be excluded by provisions in a company's articles, was wrong because *Armitage* v. *Nurse* held that all acts or omissions of the director could be indemnified or exonerated by appropriate wording in the articles, save for dishonest acts or omissions, although that would seem somewhat inconsistent with such core duties being "irreducible." In fact in *Armitage* v. *Nurse*, Millett, L.J. said ([1998] Ch. at 252):

"The nature of equitable fraud may be collected from the speech of Viscount Haldane, L.C. in *Nocton* v. *Lord Ashburton* ([1914] A.C. at 953) and *Snell's Equity*, 29th ed., at 550–551 (1990). It covers breach of fiduciary duty, undue influence, abuse of confidence, unconscionable bargains and frauds on powers. With the sole exception of the

last, which is a technical doctrine in which the word 'fraud' merely connotes excess of *vires*, it involves some dealing by the fiduciary with his principal and the risk that the fiduciary may have exploited his position to his own advantage. In *Earl of Aylesford* v. *Morris* ((1873), L.R. 8 Ch. App. at 490–491), Lord Selborne, L.C. said: 'Fraud does not here mean deceit or circumvention; it means an unconscientious use of the power arising out of these circumstances and conditions . . .' A trustee exemption clause such as cl. 15 of the settlement does not purport to exclude the liability of the fiduciary in such cases. Suppose, for example, that one of the respondents had purchased Paula's land at a proper price from his fellow trustees. The sale would be liable to be set aside. Clause 15 would not prevent this. This is not because the purchasing trustee would have been guilty of equitable fraud, but because by claiming to recover the trust property (or even *equitable compensation*), Paula would not be suing in respect of any 'loss or damage' to the trust. Her right to recover the land would not depend on proof of loss or damage. Her claim would succeed even if the sale was at an overvalue; the purchasing trustee could never obtain more than a defeasible title from such a transaction. But cl. 15 would be effective to exempt his fellow trustees from liability for making good any loss which the sale had occasioned to the trust estate so long as they had acted in good faith and what they honestly believed was Paula's interests. [Emphasis supplied.]

Accordingly, much of the argument before us which disputes the ability of a trustee exemption clause to exclude liability for equitable fraud or unconscionable behaviour is misplaced. But it is unnecessary to explore this further, for no such conduct is pleaded. What is pleaded is, at the very lowest, culpable and probably gross negligence. So, the question reduces itself to this: can a trustee exemption clause validly exclude liability for gross negligence?"

55. Millett, L.J. then said (*ibid.*, at *253*):

"I accept the submission made on behalf of Paula that there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts. But I do not accept the further submission that these core obligations include the duties of skill and care, prudence and diligence. The duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient. As Mr. Hill pertinently pointed out in his able argument, a trustee who relied on the presence of a trustee exception clause to justify what he proposed to do would thereby lose its

protection: he would be acting recklessly in the proper sense of the term."

56. It seems to me that *Armitage* v. *Nurse* (2) does not stand for the proposition that the irreducible core of obligations owed by a fiduciary, that is the duty to act honestly and in good faith, can be excluded by an exemption clause. Breach of fiduciary duty, unconscionable conduct, generally described as equitable fraud in the sense explained by Millett, L.J., resulting in a claim for equitable compensation may not be excluded.

57. It was argued on behalf of the plaintiff that the Chief Justice's analysis is correct about the irreducible core of obligations, referred to by Millett, L.J. in *Armitage* v. *Nurse*, which are fundamental, in that case to a trust, of performing the trusts honestly and in good faith for the benefit of the beneficiaries as the minimum necessary to give substance to the trust. By analogy a director has similar irreducible core fiduciary obligations to his company. The Chief Justice clearly considered that such irreducible core fiduciary obligations could not, because of their nature, be excluded and in my respectful view that is correct. The plaintiff's claim against Mr. Gilbertson is not for damages for negligence; it is for an accounting and for equitable compensation for breaches of fiduciary duty.

58. In *Armitage* v. *Nurse* (2), Millett, L.J. also said (*ibid.*, at *251*):

"It is the duty of a trustee to manage the trust property and deal with it in the interests of the beneficiaries. If he acts in a way which he does not honestly believe is in their interests then he is acting dishonestly. It does not matter whether he stands or thinks he stands to gain personally from his actions. A trustee who acts with the intention of benefiting persons who are not the objects of the trust is not the less dishonest because he does not intend to benefit himself."

59. He also said (*ibid.*, at *256*):

"It is not necessary to use the word 'fraud' or 'dishonesty' if the facts which make the conduct complained of fraudulent are pleaded; but, if the facts pleaded are consistent with innocence, then it is not open to the court to find fraud. As Buckley, L.J. said in *Belmont Finance Corporation Ltd.* v. *Williams Furniture Ltd.* ([1979] Ch. at 268):

'An allegation of dishonesty must be pleaded clearly and with particularity. That is laid down by the rules and it is a well-recognised rule of practice. This does not import that the word "fraud" or the word "dishonesty" must be necessarily used . . . The facts alleged may sufficiently demonstrate that dishonesty is allegedly involved, but where the facts are complicated this may not be so clear, and in such a case it is incumbent upon the pleader to make it clear when dishonesty is alleged.'"

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60. Having regard to the nature of their claim in the present case, it does not seem to me necessary for the plaintiff's pleading to specifically use the words "dishonest" or "dishonestly" in the context of what is alleged against Mr. Gilbertson as a director of the company. In my view, it is quite clear that the acts of Mr. Gilbertson which are alleged are, if established, self-evidently dishonest and that it is not necessary for the plaintiff to specifically use the words "dishonest" or "dishonesty" in the circumstances. It is implicit in what is pleaded. Since a director's own dishonesty is expressly excluded from the provisions of art. 132 of the company's articles of association and by implication from art. 131, if the plaintiff's case against Mr. Gilbertson is established, it does not seem to me that Mr. Gilbertson would be indemnified or exonerated pursuant to those articles. I should also mention that it was also argued on behalf of the plaintiff that even if the relevant articles did apply to Mr. Gilbertson in the circumstances they would only operate to prevent recovery of losses in the form of compensation from Mr. Gilbertson and would not bar the plaintiff on behalf of the company from suing him as a director.

61. Accordingly, it was contended, the relief sought against Autumn by way of declarations that it holds its shares in PEL as a constructive trustee for the company would not be affected. It was also contended that a claim against Mr. Gilbertson for an account of profits would not be precluded by the terms of the relevant articles. I have already expressed my view on that and on the ability to exclude claims for equitable fraud. As I have said, the plaintiff's claim is not based on allegations of negligence by Mr. Gilbertson but claims of unconscionable conduct as a fiduciary. In all the circumstances, I do not consider the arguments raised on behalf of Mr. Gilbertson with respect to the construction and effect of the relevant articles of the company's articles of association are sufficiently compelling as to justify the refusal of leave to the plaintiff to continue this action.

The multiple derivative action

62. It was also argued on behalf of Mr. Gilbertson that the relevant exception to the rule in *Foss* v. *Harbottle* (6) only arises in the context of loss or damage suffered by the company of which the plaintiff is a shareholder and on whose behalf the plaintiff seeks to bring the derivative action. In the present case, the alleged loss was suffered not by the company but by the master fund, whose shareholding in PEL was diluted as a result of Mr. Gilbertson's actions from 100% to a nominal amount. Furthermore, it was submitted, the economic benefits arising as a result of the investment of the master fund in PEL and thus the rights were not intended to flow to the company as ultimate general partner. Accordingly, it was contended that there is no basis for giving leave to continue the derivative action on behalf of the company since the company suffered no loss.

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63. In *Waddington Ltd.* v. *Chan Chun Hoo* (15), in the Court of Final Appeal of Hong Kong in September 2008, the plaintiff shareholder sought to impugn three transactions all of which were carried out by wholly-owned sub-subsidiary companies and the alleged losses were not incurred by the ultimate holding company of which the plaintiff was a minority shareholder and on whose behalf the plaintiff had purported to bring the derivative proceedings. It appears that the appellant/defendant, who was a director of the ultimate holding company as well as of the subsidiary company and the sub-subsidiary companies, made the same submission which was made on behalf of Mr. Gilbertson before me, as outlined above.

64. Having indicated that counsel in that case had not been able to discover any reasoned decision of a higher court in any common law jurisdiction outside the United States determining this question, Lord Millett said that the court would decide it as a matter of principle. He said that such an action, known as a multiple derivative action, has been entertained in England in various cases but in none of them had the plaintiff's right to bring such an action been challenged. He pointed out that *Wallersteiner* v. *Moir (No. 2)* (16) and *Airey* v. *Cordell* (1) were themselves such cases in which the plaintiff's right to maintain the action on behalf of a subsidiary of the company in which he was a shareholder was not contested or considered. No point was taken in those cases that the plaintiff was not a shareholder of the company in which the cause of action was said to be vested. Lord Millett concluded that the question whether the action may be brought by a member of the company's parent or ultimate holding company is one of *locus standi* and he went on to say ([2008] HKEC 1498, at paras. 74–75):

"On a question of standing, the court must ask itself whether the plaintiff has a legitimate interest in the relief claimed sufficient to justify him in bringing proceedings to obtain it. The answer in the case of a person wishing to bring a multiple derivative action is plainly 'yes.' Any depletion of a subsidiary's assets causes indirect loss to its parent company and its shareholders. In either case the loss is merely reflective loss mirroring the loss directly sustained by the subsidiary and as such it is not recoverable by the parent company or its shareholders for the reasons stated in *Johnson* v. *Gore Wood* ([2002] 2 A.C. 1). But this is a matter of legal policy. It is not because the law does not recognise the loss as a real loss; it is because if creditors are not to be prejudiced the loss must be recouped by the subsidiary and not recovered by its shareholders. It is impossible to understand how a person who has sustained a real albeit reflective loss which is legally recoverable only by a subsidiary can be said to have no legitimate or sufficient interest to bring proceedings on behalf of the subsidiary.

This is not to allow economic interests to prevail over legal rights.

The reflective loss which a shareholder suffers if the assets of his company are depleted is recognised by the law even if it is not directly recoverable by him. In the same way the reflective loss which a shareholder suffers if the assets of his company's subsidiary are depleted is recognised loss even if it is not directly recoverable by him. The very same reasons which justify the single derivative action also justify the multiple derivative action. To put the same point another way, if wrongdoers must not be allowed to defraud a parent company with impunity, they must not be allowed to defraud its subsidiary with impunity."

65. After considering some other arguments of the appellant/defendant, Lord Millett went on (*ibid.*, at *para. 79*):

"The last objection must also be rejected. Australia, New Zealand, Canada and Singapore have all introduced legislation to require the plaintiff to obtain the leave of the court before instituting or continuing derivative actions, and have taken the opportunity to permit multiple derivative actions where the cause of action is vested in a 'related' or 'affiliated' company of the company of which the plaintiff is a member. The various statutes have different threshold tests, different approaches to deciding whether the proposed action is in the interests of the company, and different procedures. But it is noticeable that in prescribing such requirements none of these statutes draws any distinction between the single derivative action and the multiple derivative action; and in truth there is no conceivable reason why the procedural and other requirements of the two kinds of action should differ."

66. In my opinion, Lord Millett's analysis and conclusion also represents the law in this country and I can see no reason why, in appropriate circumstances, a multiple derivative action should not be permitted. In the present case, the company is the general partner of and therefore controls the exempted limited partnership, GPLP. GPLP is itself the general partner and therefore controls the master fund. The master fund is, in my view, no different from a sub-subsidiary of the company for these purposes. On the plaintiff's case, the master fund has sustained significant loss as a result of the dilution of its 100% shareholding in PEL, procured by Mr. Gilbertson without the knowledge, still less the consent, of the master fund or GPLP or the company. In the circumstances, a multiple derivative action on behalf of the company in respect of Mr. Gilbertson's actions is not, in my judgment, objectionable.

Reflective loss

67. This leaves the question of loss. In the present case, as I have just explained, the loss of the economic benefit of marketing, exploiting and

managing the rights was sustained by the master fund and not directly by the company, although the company ultimately controls the master fund. In *Waddington Ltd.* v. *Chan Chun Hoo* (15), the plaintiff, if multiple derivative actions were not maintainable in Hong Kong, wished to bring a single derivative action on behalf of the holding company to recover the losses which it conceded were merely reflective of the losses allegedly suffered by its sub-subsidiaries and therefore *prima facie* not recoverable by the holding company. Lord Millett referred to his own speech in *Johnson* v. *Gore Wood & Co.* (7) where he said ([2002] 2 A.C. at 62):

"If the shareholder is allowed to recover in respect of such loss [reflective loss], then either there will be double recovery at the expense of the defendant or the shareholder will recover at the expense of the company and its creditors and other shareholders. Neither course can be permitted. This is a matter of principle; there is no discretion involved. Justice to the defendant requires the exclusion of one claim or the other; protection of the interests of the company's creditors requires that it is the company which is allowed to recover to the exclusion of the shareholder."

68. He concluded in *Waddington* by allowing the proceedings to continue as a multiple derivative action brought by the plaintiff shareholder of the holding company on behalf of the sub-subsidiary companies but not as a derivative action on behalf of the holding company to recover damages for reflective loss. By analogy, in the present case the plaintiff as shareholder of the company would be permitted to bring a multiple derivative action as shareholder of the company on behalf of the master fund but not a derivative action on behalf of the company to recover compensation (or an accounting) for loss reflective of the loss sustained by the master fund. In fact, in its statement of claim, as I have already explained above, the plaintiff expressly pleads that the company, including in its capacity as general partner of GPLP and, in turn, the master fund is entitled to the relief which it seeks against Mr. Gilbertson and Autumn. All of the relief sought, whether for declarations, accounting, equitable compensation, payment and interest is specifically on behalf of the company and/or GPLP and/or the master fund.

69. In my view, this makes it sufficiently clear that this is not a derivative action on behalf of the company to recover compensation for reflective loss. In fact, it was argued on behalf of the plaintiff that the company did suffer some direct loss itself as a result of Mr. Gilbertson's actions because it was intended that the company should exercise ultimate control over investments of the master fund, in this case through the master fund's intended 100% ownership of PEL, of PEL's commercial interests in the rights. That is, however, not clearly specifically pleaded as a direct loss to the company in the present statement of claim.

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The letter agreement

70. Finally, it was also submitted that another reason why leave should not be granted to the plaintiff to continue the action is because the letter agreement is null and void *ab initio*.

[The court outlined how Renova Holding had implemented a clause to terminate the agreement because of its dissatisfaction with the structure, and continued:]

71. Mr. Gilbertson argued that since the letter of agreement is to be treated as having no legal effect *ab initio*, it follows that either party was free to pursue for their personal benefit any investment opportunities which they had identified and that Mr. Gilbertson was accordingly entitled to pursue the investment in the rights himself for his own personal benefit.

72. I do not accept this argument. Mr. Gilbertson's fiduciary duties to act honestly and in good faith in his capacity as a director of the company do not derive from the letter agreement but are a matter of law. While Mr. Gilbertson may have had other more specific duties pursuant to the letter agreement, they were not his sole duties and those duties are not, in my view, affected whether or not the letter agreement is properly considered to be null and void *ab initio.* The duties of Mr. Gilbertson pleaded by the plaintiff in its statement of claim are not, or are mostly not, dependent upon the letter agreement.

Conclusion

73. In conclusion, having regard to all of the affidavit evidence and the helpful arguments and submissions of leading counsel, I have reached the view that the plaintiff should have leave pursuant to O.15, r.12A(2) of the Grand Court Rules to continue this action. I am satisfied that the plaintiff on behalf of the company has a *prima facie* case and that this is not an action which should be dismissed at this stage. As I have already indicated, I do not consider that adjourning the application or the action to enable a meeting of the shareholders of the company to consider whether the company should or should not bring the action would serve any purpose. I have also considered whether leave to continue the action up to only a certain point, such as discovery, would be appropriate but in my view, having regard to the nature of the issues in the case, it would not. There is no application by the plaintiff for indemnity of its costs of the action from the company and counsel for the plaintiff expressly states that there is no intention to make such an application. I therefore see little point in granting leave to the plaintiff to continue the action only up to a certain point. If the parties cannot reach a compromise it will have to go to trial.

74. Accordingly, I direct that Mr. Gilbertson and Autumn shall file and serve their defence or defences within 21 days of this date and that the

plaintiff shall file and serve any reply or replies within a further 21 days. On the close of pleadings the plaintiff shall file and serve a summons for directions seeking further directions, agreed if possible, for the further progress of the proceedings to trial.

75. In the circumstances, I consider it appropriate that the costs of and incidental to the hearing before me should be costs in the cause, such costs to include the cost of one leading counsel for each of the plaintiff on the one hand and Mr. Gilbertson and Autumn on the other hand.

Order accordingly.

Maples & Calder for the plaintiff; *Mourants* for the first and fifth defendants.

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Butterworths Company Law Cases/BCLC 1995 1/Barrett v Duckett and others - [1995] 1 BCLC 243

[1995] 1 BCLC 243

Barrett v Duckett and others

COURT OF APPEAL, CIVIL DIVISION

RUSSELL, BELDAM AND PETER GIBSON LJJ

20, 21, 22 , 27 1994

Derivative action - Action by shareholder on behalf of company - Whether a shareholder had locus standi to bring such an action.

Nightingale Travel Ltd (Travel) carried on the business of vehicle hirers. B was a 50% shareholder in Travel. D also held 50% of Travel's shares and was the sole director of Travel. D was also one of two shareholders in Nightingale Coaches Ltd (Coaches) and his wife was a director of that company. B, whose daughter had been married to D, commenced proceedings on behalf of Travel alleging inter alia that D and his wife had been instrumental in diverting business which rightfully belonged to Travel from Travel to Coaches. B also alleged that D had paid moneys belonging to Travel into his own bank account. D had presented a petition to wind up Travel on the grounds that the company was unable to pay its debts or that it was just and equitable that the company should be wound up. The defendants sought to strike out the action on the grounds that the action of B was not a permissible derivative action or at least to stay it until the hearing of the winding-up petition. The defendants appealed against the decision of the judge dismissing their application.

Held - Appeal allowed. A shareholder would be allowed to bring a derivative action on behalf of a company where the action was brought bona fide for the benefit of the company for wrongs to the company for which no other remedy is available and not for an ulterior purpose. Conversely, if the action was brought for an ulterior purpose or if another adequate remedy was available, the court would not allow the derivative action to proceed. On the facts, the opportunity to put the company into liquidation provided an alternative remedy to the derivative action. In addition, B was not pursuing the action bona fide in the interests of the company but was pursuing it for personal reasons associated with the divorce of her daughter from D. Accordingly, the appeal would be allowed and the action struck out.

Cases referred to in judgments

Cook v Deeks [1916] 1 AC 554, PC.

Ebrahimi v Westbourne Galleries Ltd [1972] 2 All ER 492, [1973] AC 360, [1972] 2 WLR 1289, HL.

Fargro Ltd v Godfroy [1986] BCLC 370, [1986] 3 All ER 279, [1986] 1 WLR 1134.

Ferguson v Wallbridge [1935] 3 DLR 66, [1935] 1 WWR 673, PC.

Nurcombe v Nurcombe [1984] BCLC 557, [1985] 1 All ER 65, [1985] 1 WLR 370, CA.

Wallersteiner v Moir (No 2) [1975] 1 All ER 849, [1975] QB 373, [1975] 2 WLR 389, CA.

Cases also cited or referred to in skeleton arguments

CBS/Sony Hong Kong Ltd v Television Broadcasts Ltd [1987] FSR 262, Hong Kong SC.

Chesterfield Catering Co Ltd, Re [1976] 3 All ER 294, [1977] Ch 373.

Daniels v Daniels [1978] 2 All ER 89, [1978] Ch 406.

Embassy Art Products Ltd, Re [1988] BCLC 1.

Estmanco (Kilner House) Ltd v Greater London Council [1982] 1 All ER 437, [1982] 1 WLR 2.

Forrest v Manchester, Sheffield and Lincolnshire Rly Co (1861) 4 De GF & J 126, 45 ER 1131, LC.

Foss v Harbottle (1843) 2 Hare 461, 67 ER 189.

Gibson v Barton (1875) LR 10 QB 329.

Gray v Lewis (1873) LR 8 Ch App 1035, LJJ.

Leon v York-o-Matic Ltd [1966] 3 All ER 277, [1966] 1 WLR 1450.

Maidstone Buildings Provisions Ltd, Re [1971] 3 All ER 363, [1971] 1 WLR 1085.

Mason v Harris (1879) 11 Ch D 97, CA.

Megarity v Law Society [1981] 1 All ER 641, [1982] AC 81, HL.

Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] 1 All ER 354, [1982] Ch 204, CA.

Robson v Dodds (1869) LR 8 Eq 301.

Russell v Wakefield Waterworks Co (1875) LR 20 Eq 474.

Smith v Croft [1986] BCLC 207, [1986] 1 WLR 580.

Smith v Croft (No 2) [1987] BCLC 206, [1988] Ch 114.

Western Counties Steam Bakeries & Milling Co, Re [1897] 1 Ch 617, CA.

Interlocutory appeals

By notices of appeal dated 19 November 1993 Christopher Francis Duckett, Janet Frances Duckett and Nightingale Coaches Ltd, the first, second and fourth defendants respectively in an action brought by the plaintiff, Elisabeth Ellen Barrett, appealed with the leave of the Court of Appeal (Hoffmann LJ) given on 12 November 1993 from the order of Sir Mervyn Davies sitting as a judge of the High Court in the Chancery Division dated 28 July 1993 ([1995] 1 BCLC 73) whereby he effectively dismissed their applications to strike out the action and made no order on their alternative applications for a stay of the action until after the hearing of the winding-up petition presented on 13 November 1992 against the third defendant, Nightingale Travel Ltd, in the Leicester County Court (and subsequently transferred to the High Court) but directed the action to be set down to be heard with that petition. The facts are set out in the judgment of Peter Gibson LJ.

Philip Cayford (instructed by *Harris Rosenblatt & Kramer*) for the first defendant.

Anthony Mann QC (instructed by *Ines de Vecchi*) for the second and fourth defendants.

David Guy (instructed by *Nathan Silman*) for the plaintiff.

Cur adv vult

27 July 1994. The following judgments were delivered.

PETER GIBSON LJ

(giving the first judgment at the invitation of Russell LJ). This is a most unhappy case. On its face it is an action brought by a shareholder to right grievous wrongs done to the company of which she is a shareholder. But unfortunately the circumstances in which the action is brought and pursued include a bitter matrimonial dispute between the plaintiff's daughter and the primary defendant. That bitterness appears to have infected decisions taken in relation to these proceedings, added to which there has been a notable lack of realism on the part of the plaintiff and her advisers. The litigation, even though it has not progressed beyond certain interlocutory steps, appears to have exhausted the finances of the plaintiff and, while the amounts claimed for the company are large, to an objective observer the likelihood of significant recoveries seems very small indeed. The two individual defendants who have been served with the proceedings are on legal aid. The result so far is that this litigation has been ruinous to the plaintiff and has caused heavy costs to be incurred by the public purse.

The appeal is brought by the first defendant, Christopher Duckett (Christopher), the second defendant, Janet Duckett (Janet) and the fourth defendant, Nightingale Coaches Ltd (Coaches), from the order of Sir Mervyn Davies, sitting as a judge of the High Court, on 28 July 1993 (*Barrett v Duckett* [1995] 1 BCLC 73). Those defendants had applied by motion to strike out or stay the action brought against them by the plaintiff, Elizabeth Barrett (Mrs Barrett), suing on behalf of the third defendant, Nightingale Travel Ltd (Travel), as well as herself. The judge by his order made no order on the motions and ordered that the action should be set down for hearing with a petition presented by Christopher for the winding up of Travel. The judge refused leave to appeal but such leave was granted by Hoffmann LJ.

Mrs Barrett is the widow of Mr A E Barrett and the mother of Carol Duckett (Carol). Carol was married to Christopher until their divorce on 11 February 1991. She was joined as a third party by Christopher and we have also been shown an order by the judge on 28 July 1993 by which she was made the fifth defendant and Christopher's father was made the sixth defendant in the action. This order has not been served on Carol or Christopher's father and the pleadings have not been amended to include claims against them.

Mr Barrett had carried on a coach hire business in his own name until Travel was incorporated in 1979 and

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took over that business. Christopher had worked for Mr Barrett and on Travel's incorporation he and Mr Barrett each took 50 of the 100 £1 shares in Travel and each became a director. On 19 February 1983 Mr Barrett died. Mrs Barrett inherited his shares and for ten months was a director, but she resigned at the end of 1983 when Carol became a director in her place. Christopher was the managing director and the business expanded. Travel acquired and operated several bus routes, Christopher holding the necessary certificate of competence. Travel earned profits sufficient to provide Christopher and Carol with what Mrs Barrett called 'a good living' and Mrs Barrett said that whilst their marriage subsisted she had no cause for concern about the way in which Travel's business was being conducted. She has never received any dividends from her shares nor worked for Travel.

But in February 1989 Christopher's and Carol's marriage broke down. He started to cohabit with Janet, then a certified accountant working for Travel's accountants. Later that year he offered her a job with Travel as its accountant at an annual salary of £28,000 and she commenced work at the end of October 1989. She married Christopher in August 1991. That month she was appointed company secretary, a position which she still holds.

Coaches was incorporated on 13 July 1990. It was acquired by Janet and Christopher, each of whom took one £1 share, and was given the name Portledge Coaches Ltd which they changed to its present name on 8 January 1991. Janet was the sole director of Coaches until December 1991, when she resigned as director and became the company secretary of Coaches. Christopher then became the sole director until August 1992 when he resigned and Janet and Christopher's father became the directors of Coaches. Christopher at that time also sold his one share to his father for £2,000.

In the divorce there are still unresolved ancillary relief proceedings, and it was in those proceedings that Christopher revealed serious misfeasances which had been occurring. He acknowledged that since October 1986 he had diverted cash receipts of Travel into two Post Office Giro accounts, one in the joint names of himself and Carol and the other in his sole name. Sums amounting to £89,000 were placed in the joint account and £128,000 in the sole account. Moreover those receipts were not recorded in the books or accounts or tax returns of Travel. Part of those moneys was used in the refurbishment of a second home for Christopher and Carol, The Noakes in Herefordshire. Once the diversions of Travel's moneys were revealed, draft accounts for Travel were prepared, showing those moneys as directors' loans, and the Inland Revenue were informed. Not only was tax payable on those undeclared receipts but also such loans had adverse tax consequences, attracting as they did advance corporation tax in a substantial sum on which interest ran until the loans were repaid, when there would be a right to recover the tax and interest would cease to accrue. The commonsense solution was to extinguish the loans as quickly as possible.

On the break-down of the marriage, Carol had remained with Christopher's and her two children in the jointly owned but heavily mortgaged matrimonial home in Gerrards Cross, while Christopher and Janet lived in another even more heavily mortgaged property of which Janet is the beneficial owner. The one disposable asset available to Christopher and Carol to reduce the debt to Travel was The Noakes. But Carol refused to sell The Noakes. On 27 September 1990, however, Christopher and Carol met with the Revenue and it was agreed that The Noakes should be transferred to Travel as soon as possible. But Carol refused to co-operate with Christopher on this and other matters relating to Travel; for example she refused to sign the accounts of Travel which could therefore not be filed, in breach of the directors' statutory duties. To break the impasse Christopher attempted to have another director appointed in 1990, but Mrs Barrett opposed this. However on 3 June 1991 in the matrimonial proceedings, Carol gave an undertaking to the court to resign as director and secretary of Travel forthwith and to transfer The Noakes to Travel. Despite the undertaking Carol refused to resign and it was only after an application for her committal that she finally resigned on 17 August 1991, leaving Christopher as the sole director of Travel.

A further difficulty arose between Christopher and Carol over the operation of Travel's bank account on which Carol was a signatory. The defendants say that she continued throughout 1989 and 1990 to draw cheques on that account for her own purposes and the evidence from Janet before us is that over £20,000 of what was agreed with the Revenue to be treated as the directors' loan account is represented by such drawings. Janet says that to enable Travel to have banking facilities, cheques payable to Travel from December 1990 were paid through Coaches' bank account, Coaches in turn paying cheques on behalf of

Travel and supplying cash for wages. £308,000 was paid into Coaches' bank account in this way and, it is said by Janet, paid out by Coaches on Travel's behalf.

In the meantime there had been an offer by Travel to purchase Mrs Barrett's 50 shares for £40,000 in September 1989. Those negotiations failed, but on 24 April 1991 Mrs Barrett offered to sell her shares to Christopher for £70,000 plus a tax indemnity. Christopher offered £70,000 without the indemnity, but she gave as her price, if she had to pay capital gains tax, the sum of £85,000, which was increased to £90,000 on 17 July 1991. Intertwined with the sale of shares in these negotiations was the transfer of The Noakes to Travel, consent to which was sought from Mrs Barrett, who said she would agree to it if the sale of her shares was agreed. But Christopher was unable to raise the purchase moneys demanded, and Mrs Barrett withheld her consent to the transfer and Carol hers to a sale of The Noakes. Christopher applied in the matrimonial proceedings for an order to compel Carol to sign a contract for the sale of The Noakes and on 24 February 1992 by a consent order Carol undertook to sign a sale contract and to allow the sale proceeds to go to Travel subject to a capital gains tax retention. Three months later, alarmed by the risk of repossession of the matrimonial home because no mortgage payments had been made for some months, she successfully applied to the court to be released from her undertaking to allow the sale proceeds of The Noakes to go to Travel on the ground that it represented the only available capital with which she and her children could be rehoused if they lost their home. In December 1992 The Noakes was sold and the net proceeds of just under £100,000 are held on deposit in the joint names of the solicitors of Christopher and Carol pursuant to an order of the court. Thus although Christopher had declared himself on 20 December 1990 a trustee for Travel of his interest in The Noakes, no part of the proceeds has gone to reduce the debt to Travel and interest on the tax on the directors' loans continues to accrue. On 29 May 1992 Travel's auditors advised it that the Revenue were owed £180,000, excluding penalties for the incorrect returns which have yet to be quantified.

In July 1992 the auditors advised Christopher that Travel might be insolvent and on their advice he consulted an insolvency practitioner in Messrs Pannell Kerr Forster (PKF). PKF advised on 10 August 1992 on the options for the company. They pointed out that to continue trading Travel needed continued support from the bank to which it owed £25,000 and that support was not forthcoming, the bank having requested repayment by the end of September 1992. They concluded that it would be difficult to continue trading in the long term and suggested asking the bank to appoint a receiver, which they accepted it might well not be willing to do. They continued:

> 'this presents a problem to the director as on past performance Mrs. E. Barrett would not pass a resolution to wind up the company. The way round this would be for the director to petition the Court to wind up the company due to a break down between the shareholders, the company being insolvent and no longer able to continue trading.'

That advice (in draft) had been received a little earlier and on 8 August 1992 Travel ceased to trade. It sold to Coaches its tangible assets (including its vehicles subject to hire purchase liabilities taken over by Coaches) for £36,895, that being the value put on the assets by a independent valuer. The purchase price was largely borrowed from a bank on security provided by Christopher's father. Christopher called an extraordinary general meeting of Travel at which he proposed that it enter a creditors' voluntary winding up and that a partner in PKF be appointed liquidator. But as PKF correctly forecast, that resolution was defeated by Mrs Barrett's opposition on 29 October 1992. Accordingly on 13 November 1992 Christopher petitioned in the Leicester County Court for the compulsory winding up of Travel. He did so on two grounds: one was that the company was insolvent and unable to pay its debts as they fell due; the other was on the just and equitable ground because of the deadlock position in which the company found itself. The petition has been advertised, but no creditor has appeared to support it. Mrs Barrett opposes the petition. The petition has been transferred to the High Court on the order of Vinelott J.

An estimated statement of affairs at 29 October 1992 shows that Travel's assets at their book value exceed its liabilities by £46,743. But that assumes that the directors will repay their loan account of £239,000. Even if the proceeds of The Noakes were paid to the company in part payment of the loans with a consequent reduction in the sum owed to the Revenue, the liabilities would substantially exceed the assets in the absence of further repayment of the loans.

On 11 March 1993 this action was commenced by the issue of a specially indorsed writ. By the statement of claim Mrs Barrett states that she 'brings this action in a representative capacity on behalf of Travel and/or on behalf of herself' and 'is an oppressed minority shareholder and is entitled to bring this action to recover on behalf of Travel and/or on behalf of herself.' Relief is sought under the following heads:

(A) against Christopher, damages of at least £217,000, the moneys diverted into the Post Office Giro accounts;

(B) against Christopher and/or Janet, who is alleged to be a de facto director of Travel, damages of at least £268,000 being as to £27,000 one year's pay to Janet and as to the remainder remuneration paid to Christopher between 1986/87 and 1990/91, no resolution having been passed by Travel for directors' remuneration;

(C) against Christopher, Janet and Coaches, who are alleged to have entered into a conspiracy together; (1) damages of at least £308,000 (I have already referred to what Janet has said of this sum); (2) accounts and inquiries in respect of the transfer of assets (including confidential information) from Travel to Coaches; (3) declarations that the shares in Coaches are held for Travel and that the assets of Coaches are held for Travel; and (4) a declaration that Travel is entitled to an indemnity against any liability to the Revenue arising out of the matters the subject of complaint.

On the same day Mrs Barrett moved ex parte for and obtained from Mummery J injunctive relief in Mareva form and what may be called a modified Anton Piller form, that is to say requiring the immediate disclosure of the whereabouts of documents comprising all the financial records of Travel and Coaches for the period 1 November 1989 to 31 October 1992. The applications were supported by an affidavit in which Mrs Barrett swore to her belief that Christopher, Janet and Coaches would seek to hide or destroy documents. One curious feature in respect of this order is the fact that on 19 January 1993 a draft affidavit to be sworn by Mrs Barrett in the winding-up proceedings and exhibiting a draft statement of claim for the intended Chancery proceedings (the draft being in almost identical form to that actually issued) was served on Christopher. I find it difficult to believe that Mummery J could have had his attention drawn to the fact that for more than seven weeks Christopher had been alerted to the allegations against him.

The order made by Mummery J was executed and Mrs Barrett obtained access to the records of Travel and Coaches which she sought. An affidavit was sworn by Christopher verifying his and Travel's assets. He has an equal interest with Carol in the former matrimonial home in Gerrards Cross, but because of the increasing mortgage arrears as well as 'heave' problems, it is doubtful what that interest is worth, if anything. He has an interest under Travel's pension scheme, but it is inherently improbable that he could presently obtain any moneys therefrom. He has already declared himself a trustee for Travel of his interest in The Noakes and so has no interest in its proceeds. Apart from that he has 50 shares in Travel. Janet has sworn an affidavit verifying her and Coaches' assets. She owns the equity of the house where Christopher and she live but the equity in it is only said to be worth some £20,000-£30,000. She has no other assets apart from her one share in Coaches. Coaches has vehicles worth £80,000 (subject to hire purchase liabilities) and its cash at its bank less its debt to the bank is £7,000. Christopher, Janet and Coaches promptly applied to discharge Mummery J's order, but that application has not yet been heard.

On 9 June 1993 Christopher, Janet and Coaches issued their notices of motion to strike out the action or to stay it until after the hearing of the winding-up petition presented by Christopher. They did so on the basis that an alternative remedy to the derivative action existed and that Mrs Barrett is an inappropriate person to conduct such litigation on behalf of the company. Janet also applied under RSC Ord 18, r 19 to strike out the claims made against her as a de facto director. The judge rejected those claims, holding that the practical course was to list the action for hearing with the petition (see *Barrett v Duckett* [1995] 1 BCLC 73 at 83).

The general principles governing actions in respect of wrongs done to a company or irregularities in the conduct of its affairs are not in dispute:

1. The proper plaintiff is prima facie the company.

2. Where the wrong or irregularity might be made binding on the company by a simple majority of its members, no individual shareholder is allowed to maintain an action in respect of that matter.

3. There are however recognised exceptions, one of which is where the wrongdoer has control which is or would be exercised to prevent a proper action being brought against the wrongdoer: in such a case the shareholder may bring a derivative action (his rights being derived from the company) on behalf of the company.

4. When a challenge is made to the right claimed by a shareholder to bring a derivative action on behalf of the company, it is the duty of the court to decide as a preliminary issue the question whether or not the plaintiff should be allowed to sue in that capacity.

5. In taking that decision it is not enough for the court to say that there is no plain and obvious case for striking out; it is for the shareholder to establish to the satisfaction of the court that he should be allowed to sue on behalf of the company.

6. The shareholder will be allowed to sue on behalf of the company if he is bringing the action bona fide for the benefit of the company for wrongs to the company for which no other remedy is available. Conversely if the action is brought for an ulterior purpose or if another adequate remedy is available, the court will not allow the derivative action to proceed.

Although Mrs Barrett is not a minority shareholder but a person holding the same number of shares as the other shareholder, Christopher, in the circumstances of this case she can be treated as being under the same disability as a minority shareholder in that as a practical matter it would not have been possible for her to set the company in motion to bring the action.

The debate before the judge and before us has largely turned on the applicability of the propositions in para 6 to the facts of the case, and because of their importance I will illustrate those propositions by reference to three authorities.

First on the necessity for the absence of an ulterior purpose, the words of Lawton LJ in *Nurcombe v Nurcombe* [1984] BCLC 557 at 562, [1985] 1 WLR 370 at 376 are apposite:

> 'It is pertinent to remember, however, that a minority shareholder's action in form is nothing more than a procedural device for enabling the court to do justice to a company controlled by miscreant directors or shareholders. Since the procedural device has evolved so that justice can be done for the benefit of the company, whoever comes forward to start the proceedings must be doing so for the benefit of the company and not for some other purpose. It follows that the court has to satisfy itself that the person coming forward is a proper person to do so.'

Second on the availability of alternative remedies, there are two authorities on the effect of liquidation in relation to a derivative action. In *Ferguson v Wallbridge* [1935] 3 DLR 66 at 83 Lord Blanesburgh delivering the judgment of the Privy Council said:

> 'in their Lordships' judgment, [the present action] could have been so maintained if the company were not in liquidation. *Cook v Deeks* ([1916] 1 AC 554) is clear authority for this. But could it be so maintained now that the company is assumed to be in liquidation? And the answer must again, as their Lordships think, be in the negative. The permissibility of the form of proceeding thus assumed, where the company concerned is a going concern, is an excellent illustration of the golden principle that procedure with its rules is the handmaid and not the mistress of justice. The form of action so authorised is necessitated by the fact that in the case of such a claim as was successfully made by the plaintiff in *Cook v Deeks* - and there is at least a family likeness between that case and this - justice would be denied to him if the mere possession of the company's seal in the hands of his opponents were to prevent the assertion at his instance of the corporate rights of the company as against them. But even in the case of a going company a minority shareholder is not entitled to proceed in a representative action if he is unable to show when challenged that he has exhausted every effort to secure the joinder of the company as plaintiff and has failed. But *cessante ratione legis, cessat lex ipsa*. So as soon as the company goes into liquidation the necessity for any such expedient in procedure disappears. Passing over the superficial difficulty that a company in compulsory liquidation cannot be proceeded against without the leave of the Court, the real complainants, the minority shareholders, are no longer at the mercy of the majority, wrongly retaining the property of the company by the strength of their votes. If the liquidator, acting at the behest of the majority, refuses when requested to take action in the name of the company against them, it is open to any contributory to apply to the Court, [and then he refers to the Canadian statute and says:] and under s

> 234 of the Provincial Companies Act which corresponds to s 252 of the Imperial Statute (Companies Act, 1929 (Imp.), c. 23 [now s 112 of the Insolvency Act 1986], it is open to the Court, on cause shown, either to direct the liquidator to proceed in the company's name or on proper terms as to indemnity, and otherwise to give to the applicant leave to use the company's name as plaintiff in any action necessary to be brought for the vindication of the company's rights.'

That reasoning was applied by Walton J in *Fargro Ltd v Godfroy* [1986] BCLC 370, [1986] 1 WLR 1134. In that case a minority shareholder in a company which was deadlocked wished to bring a derivative action, alleging that the other shareholder and directors had diverted assets and opportunities belonging to the company to their own use. Before the writ was issued the company went into liquidation. When the plaintiff issued the writ, the defendants applied to strike out. The application succeeded. Walton J said ([1986] BCLC 370 at 372, [1986] 1 WLR 1134 at 1136):

> 'But once the company goes into liquidation the situation is completely changed, because one no longer has a board, or indeed a shareholders' meeting, which is in any sense in control of the activities of the company of any description, let alone its litigation. Here, what has happened is that the liquidator is now the person in whom that right is vested. Now, that being the case, the plaintiff can take a variety of courses. The plaintiff can ask the liquidator to bring the action in the name of the company. Doubtless, as in virtually all cases, the liquidator will require an indemnity from the persons who wish to set the company in motion against all the costs, including, of course, the costs of the defendants, which he may have to incur in bringing that action. The liquidator may ask for unreasonable terms or, on the other hand, the liquidator may be unwilling to bring the action, and under those circumstances it is always possible for the shareholders who wish the action to be brought to go to the court asking for an order either that the liquidator bring the action in the name of the company or, more usually, that they are given the right to bring the action in the name of the company, of course, against the usual type of indemnity, which will, if there is any difficulty about the matter, be settled by the court. And I think that this has been the practice and procedure for a very long time indeed.'

He then cited *Ferguson v Wallbridge* and commented ([1986] BCLC 370 at 374, [1986] 1 WLR 1134 at 1138):

> 'So there is clear authority in the Privy Council as to the vast distinction that there is between the position where the company is a going concern and the minority shareholders' action can be brought, and a case where when it goes into liquidation where there is no longer any necessity for bringing a minority shareholders' action. Because, subject if necessary to obtaining the directions of the court, which is in itself an excellent thing as acting as a filter against any totally wrong-headed action, the action can be brought directly in the name of the company as it should be so brought.'

In *Fargro Ltd v Godfroy* the liquidator had in fact agreed to bring the action, but it is clear from the reasoning of both Lord Blanesburgh and Walton J that even if the liquidator's views were unknown the derivative action would not be allowed to proceed. The obvious factual difference between *Fargro Ltd v Godfroy* and the present case is that Travel, unlike the company in *Fargro*, was not in liquidation at the time the derivative action was commenced. I shall return later to the question whether this difference is of crucial importance in the present case.

At this point it is convenient to rehearse what seem to me to be the salient features of this case.

1. Mrs Barrett was until the breakdown of her daughter's marriage a merely passive shareholder, taking no part after 1983 in the running of Travel. She received no dividends from her holding in the company. Her only prospect of obtaining a benefit from her shares has been and is if there were to be a winding up or a sale of her shares to Christopher or the company. It is inconceivable that an outside purchaser could be found for her shares alone. At an extraordinary general meeting of Travel on 16 June 1992, her accountant and proxy, Mr Wellstood, when asked whether she was aware that her refusal to consent to the transfer of The Noakes into Travel effectively reduced her shareholding in the company to a negligible value whilst also putting the company at risk, replied that she did understand this and had written off her interest in Travel.

2. For a considerable time after being aware of the conduct of Travel's affairs of which complaint is now made by her and which plainly could be said to have been conduct in a manner which was unfairly prejudicial to her interest as a shareholder, she took no legal action, but participated in active negotiations for the sale of her shares which she offered to sell. That was a realistic attitude as she is a lady of 73 and no one has been put forward as available to run the company other than Christopher. But when those negotiations broke down on price, despite having professional advisers she did not avail herself of what one would have thought

was the plain and obvious legal remedy available to her, namely a petition under s 459 of the Companies Act 1985, asking for relief under s 461(2)(d), namely the purchase of her shares, with the alternative, if she thought the company should be recovering what had wrongly been taken from it, of seeking relief under s 461(2)(c), namely authority for civil proceedings to be brought in the name and on behalf of the company by such person or persons and on such terms as the court may direct.

3. Travel is deadlocked, has not traded since August 1992 and is probably insolvent. On the evidence before this court Christopher and Carol are unable to repay the directors' loans in full.

4. When Christopher attempted to put Travel into a creditors' voluntary liquidation, Mrs Barrett prevented it.

5. Christopher's attempt to put Travel into compulsory liquidation is opposed by Mrs Barrett because she says that she believes Travel has a future. But that future depends on her succeeding in her claim that the shares in and assets of Coaches are held in trust for Travel and also that Mr Wellstood is right in his advice to Mrs Barrett in an unsworn report made by him on 27 May 1993 after the action commenced and after examination of the documents produced by the order of 11 March 1993. In it he said that had Travel's business been offered for sale on the open market -

> 'I suspect that a price of 6 times pre-tax profits (that is the adjusted profit after adding back excess remuneration, etc.) would have been established, giving a value of approximately £400,000.'

I have to say that I regard that suspicion which is based on a large number of assumptions, as unrealistically optimistic given that it is through Christopher holding a certificate of competence that bus routes have been and are operated and that Christopher appears to have no service agreement with Travel (or Coaches for that matter).

6. It was only after Christopher's attempts to put Travel into liquidation that Mrs Barrett belatedly commenced this action. Thereby she has demonstrated that she is not content that it should be left to a liquidator to bring proceedings but that she wants control of such proceedings.

7. Travel has arguable claims against Christopher, Janet and Coaches, and some against Christopher are undisputed. There is however dispute as to whether some particular claims are arguable. For example, on the evidence before this court it may be doubted whether Mrs Barrett's advisers, in causing her to claim damages of £308,000, have understood what occurred in relation to the £308,000, and Janet hotly denies ever acting as de facto director. But it is unnecessary to decide these disputes, given that it is conceded that there are claims which in a properly constituted action should be allowed to go to trial.

8. Travel has arguable claims against Carol. In Mrs Barrett's own words (in her affidavit of 1 March 1993 in support of her application for Mareva and Anton Piller injunctions):

> 'It would seem that . . . [Christopher] and, to a lesser extent Carol, have diverted funds or stolen monies belonging to Travel and have thereby caused Travel to incur a very large liability for advance corporation tax, interest and, probably, associated fines and/or penalties.'

9. Mrs Barrett has no moneys of her own to continue this action. She says that she incurred legal costs prior to 28 July 1993 of £52,000 which used up her life savings. Surprisingly in view of *Wallersteiner v Moir (No 2)* [1975] 1 All ER 849 at 859, 865-866, [1975] QB 373 at 392, 400, she was granted legal aid until the certificate was discharged on 8 April 1994. She has applied to this court (but we have not yet heard the application) for an order that Travel should indemnify her for the costs which she has expended and will have to expend in this action, this appeal and that application. The only moneys presently available to Travel are the £36,895 proceeds of the sale to Coaches.

10. Mrs Barrett remains close to Carol and as she frankly acknowledged in her affidavit of 1 June 1993:

> 'I would be less than truthful if I were to deny that I was reluctant to sue my own daughter.'

The joinder of Carol as a defendant to the action remains, in the absence of amendment of the statement of claim to include claims against her and in the absence of service of proceedings on Carol, a token gesture.

Mr Anthony Mann QC for Janet and Coaches and Mr Cayford for Christopher point out that the circumstances of the present case are unprecedented. In all the reported cases on derivative actions the wrongdoer has by his exercise of control over the company prevented proceedings being brought against him, whereas in the present case the alleged wrongdoer, by trying to put the company into liquidation, has attempted before the action commenced and is attempting to create a situation where the allegedly oppressed minority shareholder is no longer at the mercy of the controlling shareholder and director. In my judgment the court is entitled to view with suspicion and caution the actions of the alleged wrongdoer lest on their true interpretation they are no more than attempts to defeat or at least to defer judgment being obtained against him. But in the present case it is significant that Christopher's attempts to put the company into liquidation (i) came after a long period of deadlock during which he was frustrated in his attempt to put The Noakes or its proceeds into Travel to reduce the directors' loan account and the tax debt, (ii) followed advice from an insolvency practitioner in a well-known firm of accountants and (iii) preceded not only the commencement of the action but also any intimation that the action would be commenced.

Mr Guy for Mrs Barrett submitted that the judge was right to reject the contention that she had another available remedy through proceedings in the liquidation of Travel.

First he said that it was not certain that Travel would be wound up on Christopher's petition. But that ignores the fact that Mrs Barrett was given, but rejected, the opportunity to have Travel put into a creditors' voluntary liquidation, and whilst I accept that it is possible that the court in the exercise of its discretion would not on an opposed petition compulsorily wind up the company when the petitioner is the alleged wrongdoer, that possibility is only a live one because of her opposition. Even if she continued to oppose the petition, the court may be driven to accept that there is no alternative to a winding up, given the apparent insolvency and worsening financial position of Travel while further interest accrues to the Revenue and given the deadlock in the company.

Second, Mr Guy supported the judge's comment that there was no certainty that the liquidator would sue and that Mrs Barrett had no means of compelling him to sue. Mr Guy said that the liquidator needed to incur the cost of applying to the court to sue. It is of course correct that the liquidator has a discretion. A liquidator in a compulsory liquidation can bring an action with the approval of either the liquidation committee or the court (see s 167(1) of the Insolvency Act 1986). If Mrs Barrett is aggrieved by the decision of such a liquidator, she can apply to the court under s 168(5) of the 1986 Act. In the case of a voluntary winding up, the liquidator is not obliged to obtain the sanction of the court or liquidation committee to bring any proceedings (see Sch 4, para 4 of the 1986 Act) and an aggrieved contributory has power to apply to the court under s 112(1) of the 1986 Act. But in any event it is apparent from the reasoning of Lord Blanesburgh in *Ferguson v Wallbridge* and of Walton J in *Fargro Ltd v Godfroy* that the fact that a liquidator has a discretion in relation to the bringing of an action is no answer to the objection based on the availability of an alternative remedy. No doubt the liquidator may be inhibited from pursuing claims by the shortage of available funds and may seek an indemnity from Mrs Barrett if she wants him to pursue claims which the assets available to him would not justify. But I see no injustice in that. On her own evidence she lacks the means to pursue this action further. As the company does have some money which might be used in litigating the claims, it is in my opinion manifest that it is better that the decision whether or not to use the money should be taken by an independent liquidator rather than by Mrs Barrett.

I therefore conclude that in the unusual circumstances of this case, the opportunity that Travel be put into liquidation which was offered and continues to be offered by Christopher can be said to provide an alternative remedy such as makes the derivative action inappropriate.

But the matter does not stop there. I turn to the second ground on which Mr Mann and Mr Cayford submit that this action should not be allowed to proceed, namely that Mrs Barrett has an ulterior motive which makes her an inappropriate person to bring these proceedings. On this the judge commented ([1995] 1 BCLC 73 at 82):

> 'No doubt there is ill-feeling between Mrs Barrett and Mr Duckett but that in itself cannot debar Mrs Barrett - were it to do so, most derivative actions would be frustrated.'

I see the force of that, but I am not persuaded that it is a sufficient answer to the point put against her in the light of the particular circumstances. Here I repeat what I have referred to as the salient features of this case. Personal rather than financial considerations would appear to be impelling her to pursue an action, in the outcome of which she would have no financial interest if the company were insolvent, and in preventing a winding up when that would provide the only practical means of obtaining some benefit from her shares if the company were in fact solvent.

I can well understand that Mrs Barrett is upset at what has occurred between Christopher and Carol and that she is indignant at the supplanting of Carol by Janet. But her partiality shows through all her evidence, and it is by her behaviour in relation to the claims against Carol, in contrast to the claims against Christopher and Janet, that I have become convinced that she is not pursuing this action bona fide on behalf of the company. If she had been, she would have had to sue Carol no less than Christopher in respect of diverted moneys. She claims that she did not sue Carol because Carol does not have any assets. But when Mr Guy was asked what assets Christopher had to make him worth suing, the first two items listed by Mr Guy were the jointly owned former matrimonial home in Gerrards Cross and the proceeds of The Noakes in each of which Carol retains her interest. Mr Guy sought to assure us that now that the decision had been made to sue Carol, the action would proceed against her. I am afraid that I simply do not believe that Mrs Barrett would pursue any claim against her daughter to the point of enforcing judgment: to my mind it is improbable in the extreme that she would force her daughter and grandchildren out of their home and I quite understand why she would not. Her failure to take the order making Carol a defendant any further speaks volumes. On the other hand I do not doubt that she would pursue the other defendants as far as she could, regardless of whether there is any real likelihood of recovery. This is not a satisfactory basis for an action on behalf of the company.

I am left in no doubt that this is an action which should not be allowed to proceed. Hoffmann LJ in giving leave to appeal said:

> 'As a matter of common sense, it seems arguable that the parties should not be subjected to lengthy and costly proceedings exacerbated by family hostilities when an independent liquidator might decide that the action could be settled on reasonable terms.'

I entirely agree with such argument. I hope that even now Mrs Barrett will agree to a voluntary winding up to save costs and that she will promptly give the liquidator the benefit of all the work that has been done in this case on her behalf to facilitate any proceedings which he may wish to pursue.

For these reasons I respectfully differ from the judge in his conclusions. I would allow the appeal and strike out this action.

BELDAM LJ.

In this unprofitable litigation a once successful family venture has been brought to ruin by false accounting and tax evasion for which Christopher Duckett must bear the main responsibility. The company's resulting insolvency could perhaps have been retrieved had not Carol Duckett been supplanted as wife and director by Janet Duckett. The impasse in the company's affairs is a predictable result, as is Mrs Barrett's desire, so far as she could, to ensure that Christopher and Janet Duckett should not deprive her daughter and grandchildren of a share in the profits of the business of the company her husband had built up and in which she held 50% of the shares. Mrs Barrett may not have been well advised on the choice of the steps available to her; her daughter may have gone back on an undertaking to assist in the transfer to the company of The Noakes, though the court undoubtedly considered she had grounds which justified releasing her from the undertaking. For all this, I am unimpressed by the criticisms voiced by counsel for Christopher and Janet Duckett. It does not lie well in the mouth of those who have effectively ousted Mrs Barrett's family from

sharing in the profits of the company to be critical of her, or to question her motives. Nevertheless with reluctance, rather than by persuasion by the argument, I too have reached the conclusion that the action brought by Mrs Barrett should not proceed. I have sympathy for the dilemma which faced the judge and as I am differing from his solution I shall state my reasons.

Between 1986 and 1990 a sum of £212,500 was diverted from the company's trading receipts into private accounts of the directors, Christopher and Carol Duckett. These substantial depredations seem to have escaped the notice of the company's accountants and auditors and only came to light when, in divorce proceedings between Christopher and Carol Duckett, her claim to ancillary relief for herself and the children was vigorously contested. It appears that Christopher Duckett was then advised by the company's accountants to disclose this dishonesty to the Inland Revenue and to seek the advice of insolvency practitioners. The result was an insolvency practitioner's report of 10 August 1992 with attached estimate of the state of affairs of the company showing the debt due from the directors under the cosmetic soubriquet 'Directors' Loan Account, £240,000'. To this arrangement it is said the Inland Revenue agreed. I find it difficult to see how this sum could legitimately be regarded as a loan made by the company to the directors when by s 330 of the Companies Act 1985 the company would have been prohibited from making it. As appears from the affidavits put before the court, there is no reasonable prospect of either of the directors making any significant reduction in this debt. The company is insolvent and has ceased to trade. The principal creditor appears to have decided to let matters drift.

Gibson LJ has fully described the events leading up to Mrs Barrett's resistance to a creditor's voluntary winding up and to the presentation of the winding-up petition by Christopher Duckett. Those events do not persuade me that the absence of merit on her part exceeds that of the other parties in this dispute.

If, as the judge decided, both the derivative action and the winding-up petition were to continue, the result would be even more wasteful of the company's meagre resources than the proceedings to date. Neither the action nor the petition would inevitably resolve the stalemate. Ultimately, I think, the court would be required to choose between allowing the plaintiff to pursue the company's remedies when she has not and could not realistically be expected to pursue them with the impartiality necessary for such an action or having to accede to a petition to wind up the company by a director whose criminal conduct has instigated its insolvency, a question which clearly troubled Vinelott J when he heard the application to transfer the petition to London. The public interest lies in adopting the course which is most likely to recover the revenue of which it has been defrauded.

Whilst it will be for the court hearing the winding-up petition to decide if the order can be justified on either of the grounds put forward by Christopher Duckett, I find difficulty in understanding how it could be said to be just and equitable for the court to wind up the company in these circumstances. In *Ebrahimi v Westbourne Galleries Ltd* [1972] 2 All ER 492, [1973] AC 360 Lord Wilberforce, after reviewing the authorities which led to the adoption of the words 'just and equitable' in company and partnership law, said ([1972] 2 All ER 492 at 500, [1973] AC 360 at 379):

> 'The words are a recognition of the fact that a limited company is more than a mere judicial entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure. That structure is defined by the Companies Act 1948 and by the articles of association by which shareholders agree to be bound. In most companies and in most contexts, this definition is sufficient and exhaustive, equally so whether the company is large or small. The "just and equitable" provision does not, as the respondents suggest, entitle one party to disregard the obligation he assumes by entering a company, nor the court to dispense him from it. It does, as equity always does, enable the court to subject the exercise of legal rights to equitable considerations; considerations, that is, of a personal character arising between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way.'

In the circumstances of this case the court could hardly decide that it is just and equitable for a defaulting director to exercise his right to petition to wind up this company if it is opposed by another and equal shareholder. As Lord Cross said ([1972] 2 All ER 492 at 501, [1973] AC 360 at 387):

> 'A petitioner who relies on the "just and equitable" clause must come to court with clean hands, and if the breakdown in

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> confidence between him and the other parties to the dispute appears to have been due to his misconduct he cannot insist on the company being wound up if they wish it to continue.'

Nor do I think it relevant in the circumstances of this case that Mrs Barrett was a 'passive' shareholder, content to receive no dividend from her holding, until her daughter was ousted from the company by the arrival of Janet Duckett. It is not suggested that Mrs Barrett was aware that the company's receipts were being diverted for the purpose of evading tax. She was no doubt content that her daughter and grandchildren should receive any benefits which might otherwise have accrued to her in the form of a dividend on her shares.

As to the other ground on which the petition is based, the company is undoubtedly insolvent. Both Christopher and Carol Duckett are liable to the company for the majority of the deficiency. The company has ceased trading as its assets and goodwill have been transferred to Nightingale Coaches Ltd. The company's only additional 'asset' is its undeniable cause of action against its former directors and the possibility of a claim against Janet Duckett. If a liquidator were appointed, he would be bound to proceed against the former directors and would no doubt obtain summary judgment. Any claim against Janet Duckett and Nightingale Coaches Ltd is more problematical and its pursuit would require resources which neither the company nor Mrs Barrett have. A decision whether to pursue the claim in the interests of the company having regard to the limited resources available is, in my judgment, better left to a liquidator. But there still remains the difficult question whether it is an insuperable bar to the making of a winding-up order on the ground that the company is insolvent that its insolvency was caused by the conduct of the petitioning director in taking the company's moneys and by his inability to pay them back.

I am not convinced that in all circumstances a director's past wrongdoing should be regarded as a bar to his presenting a winding-up petition. It is not in the public interest to deter those who have defrauded the Revenue from coming forward to admit their wrongdoing. Although the disclosure in the present case was prompted rather by necessity than conscience, if a winding-up order is made a liquidator would be in a position to ensure so far as he could that Christopher and Carol Duckett fulfilled their obligation to reimburse the company. No doubt some of the earnings which accrue to Christopher Duckett from the use of the assets acquired from the company could be used for this purpose.

In their original application before the judge all the appellants applied for an order that Mrs Barrett's action either be struck out or stayed. At one time I was attracted to the latter course but, on reflection, I consider that the public interest in recovering the misappropriated assets would be better served by dismissing her action and allowing the winding-up petition to continue.

RUSSELL LJ.

I agree that this appeal should be allowed and Mrs Barrett's action struck out for all the reasons appearing in the judgment of Peter Gibson LJ.

Appeal allowed.

L I Zysman Esq Barrister.

[1992–93 CILR 59]

SCHULTZ

v.

REYNOLDS and NEWPORT LIMITED

Court of Appeal

(Zacca, P., Georges and Kerr, JJ.A.)

15 April 1992

Companies—minority shareholders—right to bring action—entitled to bring action on behalf of company against directors fraudulently or negligently benefiting themselves at company's expense—no action by beneficial owner unless registered shareholder

Companies—shares—beneficial owner—joint beneficial owners—beneficial owner bringing proceedings must join co-owner in proceedings

Civil Procedure—pleading—amendment—amendment of statement of claim to introduce new cause of action may be allowed by Court of Appeal even though statement of claim already struck out by Grand Court

The appellant brought an action against the first respondent in the Grand Court for breach of trust.

The appellant alleged that D had agreed to pay her US$500,000 for certain business services she had performed for him. A company (the second respondent) was formed and the money deposited in an account in its name at the Canadian Imperial Bank of Commerce ("CIBC"). The shares in the company were held by a nominee shareholder, Commerce Management Services ("CMS"), jointly for the benefit of the appellant and D. CMS, a wholly-owned subsidiary of CIBC, managed the affairs of the new company, the directors of which were the first respondent (a trust officer with CIBC) and four other local employees of CIBC. They were also the subscribers to its memorandum of association. The first respondent explained that the purpose of this arrangement was to ensure that, should the appellant predecease D, any sums to the credit of the account would accrue to him but as long as she was alive the funds would be hers and under her control. Nonetheless, the printed nominee agreement form allowed "any one/all of the beneficial owners" to authorize the transfer of the shares.

The appellant suspected that the money was no longer in the account and discovered that the first respondent, acting on instructions from D, had transferred the money to another account in D's name. She brought the present proceedings on behalf of the company against the first respondent for breach of trust and, since it was a derivative action, she also named the company as a defendant.

The first respondent applied for the action to be struck out on the grounds that the appellant had no *locus standi* and her statement of claim disclosed no cause of action. The Grand Court (Malone, C.J.)

held that there was an arguable case that she was entitled to sue on the company's behalf but nevertheless struck out the statement of claim for disclosing no cause of action.

The appellant appealed but first sought an amendment to the statement of claim to include an allegation of conspiracy. The application for the amendment was heard in the course of the appeal.

The appellant submitted that (a) as a beneficial owner of the shares in the second respondent she was entitled to bring the action in her own name; (b) to bring a derivative action she needed to prove only that a fraud had been committed by the first respondent and that he was legally in control of the second respondent. She was not required to prove that he had personally benefited from the fraud; (c) his fraud stemmed from the fact that he knew that the money had been deposited in the account for her own use and had transferred it without her knowledge; (d) the action had been properly brought against the first respondent since in his capacity as one of the directors of the second respondent, all of whom were employees of the bank that ultimately controlled that company, he was in fact and law in control of it; and (e) there had been a conspiracy between the first respondent, the bank and the other beneficial owner of the shares to commit a breach of trust against the second respondent by unlawfully utilizing its funds against its interest.

The first respondent submitted in reply that (a) under the Companies Law (Revised), s.37 the appellant, being neither a member nor a shareholder of the second respondent, had no *locus standi* to bring or sustain an action on its behalf; (b) any wrong allegedly suffered would have been suffered by the company, which alone could sue; (c) even if the appellant were entitled to bring an action on behalf of the second respondent, she had failed in essence to establish a cause of action because it was clear that he did not control the second respondent and no facts had been pleaded to support a claim of fraud or negligent breach of trust nor to show what benefit he had derived from the act complained of; (d) it was essential to establish in a derivative action that the alleged wrongdoer was not only in control of the company on whose behalf the suit was brought but that the act complained of was committed with the intention of bringing some benefit to himself; and (e) the court had no jurisdiction on an appeal to grant the amendment sought since the appellant's defective statement of claim had already been struck out and, accordingly, there was no document which could be amended.

Held, dismissing the appeal:

(1) It was the general rule that the proper plaintiff in an action in respect of a wrong alleged to be done to a company was *prima facie* the company itself and, as an exception, a minority shareholder might bring a derivative action on behalf of the company against the wrongdoers if they used their controlling powers either fraudulently or negligently with the intention of benefiting themselves at the expense of the company. Accordingly, the appellant would have been able to bring a

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derivative action if she had been a minority shareholder, but as she was not (being only the beneficial owner of shares in the company), she could not sue on its behalf and it was only the subsidiary company of the bank, in which name all the shares of the second respondent were registered, that could do so. In any case, as one of two joint beneficial owners, the appellant also lacked the capacity to sue on her own but would have had to join her co-owner. It would have been more appropriate to bring a different type of action naming her co-owner and the nominee shareholding company as defendants (page 63, line 40 – page 64, line 4; page 67, lines 3–7; page 69, lines 27–38; page 77, lines 1–15).

(2) Moreover, there seemed to be no justification for bringing proceedings against the first respondent. The first respondent was a director but not a shareholder of the second respondent, which was legally controlled by a nominee shareholding company, a subsidiary of the bank employing the first respondent and other directors of the second respondent. However, it did not follow from this that the first respondent controlled the second respondent. On the contrary, he was under a legal obligation to act independently in the interests of the second respondent and was under no obligation to heed the wishes of his employer, the bank. There was also nothing pleaded to establish fraud or that the first respondent had gained any benefit from his alleged breach of trust or wrongful exercise of authority *vis-a-vis* the second respondent and proof of improper benefit was essential—whether the act complained of was fraudulent or negligent—for the appellant to succeed. Accordingly, on the statement of claim as it stood, no cause of action had been established and it had been properly struck out (page 72, line 12 – page 73, line 8; page 79, line 17 – page 80, line 11).

(3) Since the Grand Court would certainly have been able to allow an amendment to the appellant's statement of claim to bring in a plea of conspiracy, the Court of Appeal, because it had all of the powers of the Grand Court, had the jurisdiction to entertain such an application, in spite of the striking out of the statement of claim. However, it would be unfair to the respondents to allow the amendment at such a stage of the proceedings and since, in any case, there were other courses of action open to the appellant by which she could more appropriately seek redress for the wrongs suffered, the application for amendment would be dismissed (page 73, lines 18–29; page 80, line 40 – page 81, line 16).

Cases cited:

(1) *Bagshaw v. Eastern Union Ry. Co.* (1849), 7 Hare 114; 68 E.R. 46, considered.

(2) *Birch v. Sullivan*, [1957] 1 W.L.R. 1247; [1958] 1 All E.R. 56, *dicta* of Harman, J. considered.

(3) *Burland v. Earle*, [1902] A.C. 83; (1902), 71 L.J.P.C. 1, *dicta* of Lord Davey applied.

(4) *Daniels v. Daniels* , [1978] Ch. 406; [1978] 2 All E.R. 89, *dicta* of Templeman, J. applied.

(5) *Edwards v. Halliwell*, [1950] 2 All E.R. 1064; (1950), 94 Sol. Jo. 803, *dicta* of Jenkins, L.J. applied.

(6) *Estmanco (Kilner House) Ltd. v. G.L.C.*, [1982] 1 W.L.R. 2; [1982] 1 All E.R. 437, *dicta* of Megarry, V.-C. applied.

(7) *Exchange Travel (Holdings) Ltd., Re*, [1991] BCLC 728, *dictum* of Harman, J. applied.

(8) *Fargro Ltd. v. Godfroy*, [1986] 1 W.L.R. 1134; [1986] 3 All E.R. 279; [1986] BCLC 370, considered.

(9) *Foss v. Harbottle* (1843), 2 Hare 461; 67 E.R. 189, applied.

(10) *Great W. Ry. Co. v. Rushout* (1852), 5 De G. & Sm. 290; 64 E.R. 1121, distinguished.

(11) *Kuwait Asia Bank E.C. v. National Mutual Life Nominees Ltd.*, [1991] 1 A.C. 187; [1990] 3 All E.R. 404; [1990] 2 Lloyd's Rep. 95, considered.

(12) *Lonrho PLC v. Fayed*, [1992] 1 A.C. 448; [1991] 3 All E.R. 303; [1991] BCLC 779.

(13) *Lonhro Ltd. v. Shell Petroleum Co. Ltd.*, [1982] A.C. 173; [1981] 2 All E.R. 456.

(14) *Metall & Rohstoff AG v. Donaldson, Lufkin & Jenrette Inc.*, [1990] 1 Q.B. 391; [1989] 3 All E.R. 14.

(15) *Prudential Assur. Co. Ltd. v. Newman Indus. Ltd. (No. 2)*, [1981] Ch. 257; [1980] 2 All E.R. 841; on appeal, [1982] Ch. 204; [1982] 1 All E.R. 354, applied.

(16) *Stena Fin. BV v. Sea Containers Ltd.*, [1989] LRC (Comm.) 641, considered.

(17) *Telecommunications of Jamaica Ltd. v. Bernard*, Court of Appeal of Jamaica, Case No. 88 of 1990, unreported, applied.

(18) *Wallersteiner v. Moir (No. 2)*, [1975] Q.B. 373; [1975] 1 All E.R. 847, *dicta* of Lord Denning, M.R. applied.

(19) *Williams v. British Gas Corp.* (1980), 41 P. & C.R. 106; 257 E.G. 833.

Legislation construed:

Companies Law (Revised) (Laws of the Cayman Islands, 1963, *cap.* 22, revised 1990), s.37:

"The subscribers of the memorandum of association of any company shall be deemed to have agreed to become members of the company whose memorandum they have subscribed, and upon the registration of the company shall be entered as members on the Register of members hereinafter mentioned, and every other person who has agreed to become a member of a company and whose name is entered on the register of members, shall be deemed to be a member of the company."

P. Lamontagne, Q.C. and *D. Bannon* for the appellant;

R.D. Alberga, Q.C. and *N. Clifford* for the first respondent.

The second respondent did not appear and was not represented.

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ZACCA, P.: This is an appeal against the order of the Grand Court Judge striking out a writ of summons and statement of claim filed by the appellant on the ground that she had no *locus standi*. The appellant in her statement of claim and in her affidavit alleged that she performed certain services for one Robert Dupre and that he agreed to pay her US$500,000.

A meeting was arranged between the first respondent, herself and Dupre at the Canadian Imperial Bank of Commerce ("CIBC"). The first respondent was a senior trust officer with the bank. It was agreed that a company was to be formed and the money was to be deposited to the account of that company. Newport Ltd., a Cayman company, was incorporated for the purpose. Another Cayman company called Commerce Management Sevices Ltd. ("CMS") was a subscriber to the memorandum of association of Newport Ltd. Five persons, all employees of CIBC, were appointed directors of Newport Ltd. The respondent, Anthony Reynolds, was one of the directors so appointed. The same five directors were also directors of CMS.

100 shares in Newport Ltd. were issued to CMS. A nominee agreement was executed in which CMS was to hold the 100 shares it had as nominee for the appellant and Robert DuPre. The agreement records that all the 100 shares are the joint property of the appellant and Dupre. The appellant and Dupre were therefore the beneficial owners of the shares.

It was also alleged that subsequent to the money being deposited in the account of Newport Ltd., it was transferred with the knowledge of the respondent to an account at CIBC in the name of Robert Dupre at his request. The transfer was done as if in repayment of a loan made by Dupre. No action has been commenced against any of the alleged wrongdoers other than the respondent Reynolds. Dupre was not joined as a defendant.

It is not in dispute that the appellant has brought this claim on behalf of the second respondent, Newport Ltd. Nor is it in dispute that the appellant is bringing a derivative action for the second respondent, Newport Ltd., and not on behalf of herself. It is well established that a minority shareholder can bring a derivative action on behalf of the company against wrongdoers who have committed a fraud on the company and who are in control of the company.

The general principle established in *Foss* v. *Harbottle* (9) is that where a wrong has been done to a company, *prima facie* the only

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proper plaintiff is the company itself and that an action by a shareholder claiming relief for the company is not available. The plaintiff may only bring a derivative action if it falls within the exceptions to the rule in *Foss* v. *Harbottle*.

5 In *Edwards* v. *Halliwell* (5) the rule in *Foss* v. *Harbottle* was considered. Jenkins, L.J. stated ([1950] 2 All E.R. at 1067):

> "The cases falling within the general ambit of the rule are subject to certain exceptions. It has been noted in the course of argument that in cases where the act complained of is
> 10 wholly *ultra vires* the company or association the rule has no application because there is no question of the transaction being confirmed by any majority. It has been further pointed out that where what has been done amounts to what is generally called in these cases a fraud on the minority and
> 15 the wrongdoers are themselves in charge of the company, the rule is relaxed in favour of the aggrieved minority who are allowed to bring what is known as a minority shareholders' action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance
> 20 could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue. Those exceptions are not directly in point in this case, but they show, especially the last one, that the rule is not an inflexible rule and it will be relaxed where necessary in the
> 25 interests of justice."

In *Prudential Assur. Co. Ltd.* v. *Newman Indus. Ltd. (No. 2)* (15) the court, comprising Cumming-Bruce, Templeman and Brightman, L.JJ. stated ([1982] 1 All E.R. at 357–358):

> "The classic definition of the rule in *Foss v. Harbottle* is
> 30 stated in the judgment of Jenkins, L.J. in *Edwards v. Halliwell* [1950] 2 All E.R. 1064 at 1066–1067 as follows. (1) The proper plaintiff in an action in respect of a wrong alleged to be done to a corporation is, prima facie, the corporation. (2) Where the alleged wrong is a transaction which might be
> 35 made binding on the corporation and on all its members by a simple majority of the members, no individual member of the corporation is allowed to maintain an action in respect of the matter because, if the majority confirms the transaction, cadit quaestio; or, if the majority challenges the transaction,
> 40 there is no valid reason why the company should not sue. (3) There is no room for the operation of the rule if the alleged

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wrong is ultra vires the corporation, because the majority of members cannot confirm the transaction. (4) There is also no room for the operation of the rule if the transaction complained of could be validly done or sanctioned only by a special resolution or the like, because a simple majority cannot confirm a transaction which requires the concurrence of a greater majority. (5) There is an exception to the rule where what has been done amounts to fraud and the wrongdoers are themselves in control of the company. In this case the rule is relaxed in favour of the aggrieved minority, who are allowed to bring a minority shareholders' action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue."

In *Wallersteiner* v. *Moir (No. 2)* Lord Denning, M.R. stated ([1975] 1 All E.R. at 858):

"To avoid that circuity, Lord Hatherley, L.C. held that the minority shareholders themselves could bring an action in their own names (but in truth on behalf of the company) against the wrongdoing directors for the damage done by them to the company, provided always that it was impossible to get the company itself to sue them. He ordered the fraudulent directors in that case to repay the sums to the company, be it noted, with interest. His decision was emphatically approved by this court in *Menier v. Hoopers' Telegraph Works*; and *Mason v. Harris*. The form of the action is always 'AB (a minority shareholder) on behalf of himself and all other shareholders of the Company' against the wrongdoing directors and the company. That form of action was said by Lord Davey to be a 'mere matter of procedure in order to give a remedy for a wrong which would otherwise escape redress'; see *Burland v. Earle*. Stripped of mere procedure, the principle is that, where the wrongdoers themselves control the company, an action can be brought on behalf of the company by the minority shareholders, on the footing that they are its representatives, to obtain redress on its behalf. I am glad to find this principle well stated by Professor Gower in his book on companies in words which I would gratefully adopt:

'Where such an action is allowed the member is not

really suing on his own behalf nor on behalf of the members generally, but on behalf of the company itself. Although . . . he will have to frame his action as a representative one on behalf of himself and all the members other than the wrongdoers, this gives a misleading impression of what really occurs. The plaintiff shareholder is not acting as a representative of the other shareholders but as a representative of the company . . . in the United States . . . this type of action has been given the distinctive name of a "derivative action," recognising that its true nature is that the individual member sues on behalf of the company to enforce rights derived from it.' "

Mr. Alberga, Q.C. for the respondent submitted that unless the appellant can show that she is a shareholder of Newport Ltd., she has no *locus standi* and cannot sustain the action. Mr Lamontagne, Q.C. for the appellant submitted that she is a beneficial owner of the shares and as such is entitled to bring the action in her name.

CMS became the nominee of the appellant and Dupre under a nominee agreement of September 4th, 1989, which provides in part:

> "The shares of the company will be transferred to the beneficial owners or their nominees in accordance with such directions as any one/all of the beneficial owners may give and for the aforesaid purposes the corporate nominee hereby authorizes any one/all of the beneficial owners to sign all such transfers or other forms as may be necessary for registration of the shares of the company in the name of the beneficial owners or that of their nominees."

The register of Newport Ltd. shows CMS to be the sole member of Newport Ltd.

Section 37 of the Companies Law (Revised) defines those who are members of a company. The section provides as follows:

> "The subscribers of the memorandum of association of any company shall be deemed to have agreed to become members of the company whose memorandum they have subscribed, and upon the registration of the company shall be entered as members on the Register of members hereinafter mentioned, and every other person who has agreed to become a member of a company and whose name is entered

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> on the register of members, shall be deemed to be a member of the company."

The appellant is therefore not a member of the company in accordance with s.37 of the Companies Law (Revised). Can it 5 therefore be said that the appellant is a shareholder of Newport Ltd.? In the alternative, if she is not a shareholder, can she as beneficial owner of the shares maintain this action?

In *Birch* v. *Sullivan* (2) the action was stayed because the plaintiff at the time of trial was not registered as a shareholder. 10 The plaintiff was adjudged a bankrupt and the trustee in bankruptcy was regarded as the shareholder. Harman, J. stated ([1958] 1 All E.R. at 58):

> "The circumstances are well settled in which a shareholder, if he be in the minority, may bring such an action in his own 15 name. Supposing that all the conditions were satisfied and that the registered shareholder was in a position, if he were not bankrupt, to bring an action because of the wrongful act of the director in not paying money to the company, I am not satisfied that he could not maintain such an action as long as 20 he remained registered. However that may be, he certainly can no longer maintain the action when he has ceased to be a registered holder. Therefore, on that part of the claim, I should certainly stay the action as long as the plaintiff alone remains the plaintiff, giving a reasonable opportunity to the 25 trustee to put the matter right if he is minded to adopt the action."

In *Fargro Ltd.* v. *Godfroy* (8) it was held that the plaintiff could not bring a minority shareholder's action because the company was in liquidation. If the company had not been in liquidation the 30 plaintiff, being a shareholder of the company, would have been entitled to bring the action. Mr. Lamontagne submits that the appellant as a beneficial owner of the shares was entitled to bring this action. In support of his proposition he relies on the case of *Stena Fin. BV* v. *Sea Containers Ltd.* (16). In that case, a 35 preliminary point was taken that the plaintiff, Temple, was not a registered holder of shares when the action was brought and therefore had no *locus standi*. However, it was pointed out that Temple had been registered as the owner of the shares at the time of trial. It was in these circumstances that Astwood, C.J. stated 40 ([1989] LRC (Comm.) at 666):

> "In the instant case no harm is done since I hold, on

> reviewing the pleadings and having considered the submissions of counsel, that Temple has locus since they were absolute beneficial owners of the shares when the action was started and Stena can maintain the action in its own right as a
> 5 member of the company."

Mr. Lamontagne also relied on the case of *Great W. Ry. Co.* v. *Rushout* (10). In that case, the Great Western Railway Co. became shareholders holding 3,600 shares in the company standing in the name of 4 persons who were defendants in the
10 suit, upon certain trusts in an indenture dated March 23rd, 1948. It was contended that the plaintiffs had no right to sustain the suit because its object was to affect the internal management of the company, and the plaintiffs did not appear in the share list as shareholders. In his judgment, Parker, V.-C. stated (5 De G. &
15 Sm. at 306–307; 64 E.R. at 1129):

> "It appears by the bill, and upon the affidavits, that the Plaintiffs are not shareholders in their own name in this company; but the bill states, and it is proved by affidavit, that they have got a large number of shares that are standing in
> 20 the names of four persons, who are trustees for the Plaintiffs, and who are named as Defendants to this record; and in that state of matters it was contended that the company had no such interest as enabled them to maintain this suit, suing on behalf of themselves and all other the shareholders.
>
> 25 With reference to that question, I think they have an interest to maintain this suit. There is a valid trust, beyond all doubt valid, on which these shares are held for the Great Western Railway Company, they are the only persons who, under that trust, are interested in the shares. They have
> 30 therefore an interest in what is sought by this bill to protect the property and concerns of this company.
>
> It is very true that, for many purposes, the company are only bound to regard the legal title. One of the clauses of the Act is that the company shall not be bound to see to the
> 35 execution of any trust. Now, they are not asked here to see to the execution of any trust, they are only asked to act on a title, which is a trust executed, and is an equitable not a legal title; and enabling these parties to maintain this suit does not in any way change the jurisdiction on the subject-matter: so
> 40 that I must assume for this purpose that the legal shareholders themselves could maintain this bill. It is not like

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> those cases in which the *cestui que trust* suing in this Court, and making the trustee a Defendant, asserts a right against another party, which is a right to be asserted by the trustee in a Court of law. The trustee, or *cestui que trust*, can sue in this 5 Court, and therefore that objection cannot apply; and, when it is added to this that the trustees themselves, the persons who are the legal owners of the shares, are parties to the suit, and bound by the proceedings, I confess I do not see any objection to the frame of the suit. Moreover, the Act of 10 Parliament itself assumes that the Great Western Railway Company may have an equitable title in these shares; for it provides, in the 12th section, that, having taken these shares, they may guarantee interest on the money necessary to be raised to enable them to take the shares, on such conditions 15 as the holders for the time being of the shares, or the parties in whose hands they may be placed as security, may agree upon. It appears that these shares are, in fact, placed in the hands of the trustees, subject to certain guarantees, and pursuant to that clause; so that we have the Great Western 20 Railway Company here precisely in the position which the Act of Parliament regulating the Oxford, Worcester and Wolverhampton Railway Company contemplated, namely, having an equitable title in these shares, but subject to those guarantees held by the persons who are the owners of the 25 shares. For these reasons, I think the suit is properly constituted as to its frame."

The Companies Law (Revised) recognizes only members who are registered. The appellant has no voting rights and as a beneficial owner of the shares has no rights under the Law. The 30 instant case can therefore be distinguished from the *Great W. Railway* case.

In my view it is only CMS, the registered shareholder of Newport Ltd., who can institute an action against Newport Ltd. The appellant, as a beneficial owner of the shares, is not entitled 35 to bring a derivative action against Newport Ltd.

Another hurdle for the appellant is that she is a joint beneficial holder of the shares with Dupre. She must therefore act jointly with Dupre and cannot pursue the action on her own. In *Williams* v. *British Gas Corp.* (19) it was held that one of two joint tenants 40 cannot commence proceedings without the aid of the other. Again, in *Re Exchange Travel (Holdings) Ltd.* (7) it was held that

joint shareholders could only act together. Both Dupre and CMS would have to be joined as plaintiffs or as defendants. Obviously they would not consent to be joined as plaintiffs. The learned Chief Justice was therefore in error in holding that there was an arguable case as to the appellant's right to bring this action. No reliance should have been placed on the case of *Bagshaw* v. *Eastern Union Ry. Co.* (1).

The Chief Justice in his judgment concluded that wrongdoers cannot be held to have committed a "fraud upon the minority" unless it can be shown that the wrongdoers have obtained a benefit as a result of their actions. This was necessary to bring the case within the exception to the rule in *Foss* v. *Harbottle* (9). Mr. Lamontagne submitted that where fraud was proved, the element of personal gain from the fraud need not be established. It is not contended that the respondent received any personal benefit by paying out the money from the accounts of Newport Ltd. to Dupre. It was, however, argued by Mr. Lamontagne that his action amounted to fraud as a result of the misappropriation of the company's funds.

In *Burland* v. *Earle* (3) Lord Davey stated ([1902] A.C. at 93):

> "Again, it is clear law that in order to redress a wrong done to the company or to recover moneys or damages alleged to be due to the company, the action should primâ facie be brought by the company itself. These cardinal principles are laid down in the well-known cases of *Foss* v. *Harbottle* . . . and *Mozley* v. *Alston* . . . and in numerous later cases which it is unnecesary to cite. But an exception is made to the second rule, where the persons against whom the relief is sought themselves hold and control the majority of the shares in the company, and will not permit an action to be brought in the name of the company. In that case the Courts allow the shareholders complaining to bring an action in their own names. This, however, is mere matter of procedure in order to give a remedy for a wrong which would otherwise escape redress, and it is obvious that in such an action the plaintiffs cannot have a larger right to relief than the company itself would have if it were the plaintiff, and cannot complain of acts which are valid if done with the approval of the majority of the shareholders, or are capable of being confirmed by the majority. The cases in which the minority can maintain such an action are, therefore, confined

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to those in which the acts complained of are of a fraudulent character or beyond the powers of the company. A familiar example is where the majority are endeavouring directly or indirectly to appropriate to themselves money, property, or advantages which belong to the company, or in which the other shareholders are entitled to participate, as was alleged in the case of *Menier* v. *Hooper's Telegraph Works*. . . ."

In considering the exception to the rule in *Foss* v. *Harbottle* (9) which requires the plaintiff in a minority shareholder's action to establish fraud on the part of the wrongdoer and that the wrongdoers were in control of the company, Vinelott, J. in *Prudential Assur. Co. Ltd.* v. *Newman Indus. Ltd. (No. 2)* (15) stated ([1980] 2 All E.R. at 869):

"Thus the authorities show that the exception applies not only where the allegation is that directors who control a company have improperly appropriated to themselves money, property or advantages which belong to the company or, in breach of their duty to the company, have diverted business to themselves which ought to have been given to the company, but more generally where it is alleged that directors though acting 'in the belief that they were doing nothing wrong' (per Lord Lindley, M.R. in *Alexander v. Automatic Telephone Co.*, [1900] 2 Ch. 56 at 65) are guilty of a breach of duty to the company (including their duty to exercise proper care) and as a result of that breach obtain some benefit. In the latter case it must be unnecessary to allege and prove that the directors in breaking their duty to the company acted with a view to benefiting themselves at the expense of the company; for such an allegation would be an allegation of misappropriation of the company's property. On the other hand, the exception does not apply if all that is alleged is that directors who control a company are liable to the company for damages for negligence it not being shown that the transaction was one in which they were interested or that they have in fact obtained any benefit from it."

In *Daniels* v. *Daniels* (4) Templeman, J. said ([1978] 2 All E.R. at 96):

"The principle which may be gleaned from *Alexander v. Automatic Telephone Co.* (directors benefiting themselves) from *Cook v. Deeks* (directors diverting business in their own favour) and from dicta in *Pavlides v. Jensen* (directors

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appropriating assets of the company) is that a minority shareholder who has no other remedy may sue where directors use their powers intentionally or unintentionally, fraudulently or negligently in a manner which benefits
5 themselves at the expense of the company. This principle is not contrary to *Turquand v. Marshal* because in that case the powers of the directors were effectively wielded not by the director who benefited but by the majority of independent directors who were acting bona fide and did not benefit."

10 In *Estmanco (Kilner House) Ltd.* v. *G.L.C.* (6) Megarry, V.-C. accepted the principle laid down by Templeman, J. in *Daniels* v. *Daniels*. The Court of Appeal in Jamaica in the case of *Telecommunications of Jamaica Ltd.* v. *Bernard* (17) was also of the view that it must be shown that there was a benefit to the
15 directors whose wrongdoing is the subject of the complaint. I see no reason for departing from this conclusion and would hold that the decision was a correct one.

The only person against whom wrongdoing is alleged is the respondent Reynolds. No evidence has been established to
20 suggest that Reynolds received any benefit from his actions in having the money transferred from Newport's account to Dupre. The facts do not fall within the exception to the rule in *Foss* v. *Harbottle* (9). The appellant has not established the essential element of fraud which is necessary to bring the claim within the
25 exception to the rule in *Foss* v. *Harbottle*.

Another issue was whether the alleged wrongdoer controls Newport Ltd. The appellant must show not only that there was fraud on the part of Reynolds but that he controlled Newport Ltd. This is necessary to bring the claim within the exception to
30 the rule in *Foss* v. *Harbottle*. The evidence does not disclose that Reynolds is in control of the company. He is not a shareholder in the company. He is one of five directors and has no voting rights. The shares in the company are held by CMS. The register of Newport Ltd. shows this to be so. It has been suggested by Mr.
35 Lamontagne that CMS is a subsidiary of CIBC and since all the directors of Newport Ltd. and CMS are employees of CIBC, that consequently CIBC controls the board of Newport Ltd. and CMS. This submission cannot be accepted as a correct one.

Mr. Lamontagne referred the court to *Kuwait Asia Bank E.C.*
40 v. *National Mutual Life Nominees Ltd.* (11). In that case the Privy Council held that nominee directors of a company were under a

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duty to exercise such diligence and skill as may be required of them in the interest of the company of which they were directors. However, they were bound to ignore the interests of their employer. The directors of Newport Ltd. have a duty to act in the best interest of the company regardless of the wishes of CIBC.

There can be no legal control of Newport Ltd. by CIBC. It cannot therefore be said that Reynolds controls Newport Ltd. Such legal control is vested in CMS.

In order to cure the defect of the appellant's claim against Reynolds for fraud, the appellant sought to amend the statement of claim by adding a new para. 27 as follows:

> "Further and in the alternative, Reynolds, CIBC, and Dupre have conspired together and with each other to deprive Newport Ltd., by the unlawful means set out in paras. 20, 21, 22, 23, 25 and 26 hereof, of the funds held in its account with CIBC and to transfer the said funds to Dupre by the said unlawful means."

Mr Alberga argued that the court had no jurisdiction to entertain the amendment. This court has all the powers of the Grand Court and there is no doubt that had the application been made to the Grand Court, the court would have had the jurisdiction to entertain the application. The reasons given by the appellant for not including the claim of conspiracy in the original pleadings are no longer applicable having regard to the decision in the House of Lords in *Lonrho PLC* v. *Fayed* (12).

Having regard to the circumstances of the instant case, I would not allow the application for the amendment. The appellant may yet be able to bring a new action for the wrong alleged to be suffered by her.

I would, for the reasons stated above, dismiss the appeal with costs to the respondent to be taxed or agreed.

GEORGES, J.A.: The dispute in this case arises from a promise alleged to have been made by an American businessman, Robert Dupre, to the appellant, Kirsten Schultz, to pay her US$500,000 for services rendered with respect to certain projects. The money was to have been deposited into a bank account in Grand Cayman in her name. No such deposit was ever made, but on September 4th, 1989 the appellant and Dupre met at the office of the Canadian Imperial Bank of Commerce ("CIBC") in Grand Cayman. Dupre was a customer of CIBC and it would appear

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that the purpose of the meeting was to arrange the implementation of the promise. Present at the meeting was Anthony Reynolds, the first respondent, then a senior trust officer on the trust side of the operations of CIBC in Grand Cayman. The 5 appellant states that Reynolds well knew that Dupre was to pay to her for her own use the sum of $500,000.

She further states that Reynolds advised that the payment should be arranged in the following way. A company would be incorporated under the name Newport Ltd. The shares in that 10 company would be held by a nominee shareholder, Commerce Management Services ("CMS"), jointly for the benefit of the appellant and Dupre. CMS, a wholly owned subsidiary of CIBC, would manage Newport Ltd. The directors of Newport Ltd. would be himself, Reynolds and four other employees of CIBC. 15 Newport Ltd. would open an account with CIBC and the $500,000 would be deposited into that account. Reynolds explained that the purpose of the arrangement was to ensure that should the appellant predecease Dupre any sums to the credit of the account would accrue to Dupre, but so long as she was alive 20 the funds to the credit of the account would be hers and under her control. She knew nothing about the operation of offshore accounts so she accepted Reynolds' advice and relied on his assurances.

The appellant and Dupre signed a nominee agreement, a 25 printed form, appointing CMS, their nominee, to hold 100 shares of Newport Ltd. for them as beneficial owners. The shares were declared to be the joint property of the appellant and Dupre and were held for the benefit of the survivor. The shares could be transferred—

30 > "in accordance with such directions as any one/all of the beneficial owners may give and for the aforesaid purposes the corporate nominee hereby authorizes any one/all of the beneficial owners . . . to sign such transfers. . . ."

There was clearly an intention that either "any one" or "all" 35 should have been deleted but this was not done.

Newport Ltd., the second respondent, was in fact incorporated, the subscribers to the memorandum being Reynolds and four other employees of CIBC. The first meeting was held. Reynolds was appointed President. Share certificates were issued 40 to CMS. Reynolds and the four other subscribers were named directors. A resolution was passed appointing CIBC bankers. On

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September 4th, 1989 Dupre gave instructions for the transfer of $500,000 to the account of Newport Ltd. when it was incorporated.

The appellant in the course of time became suspicious that the sum deposited in the account of Newport Ltd. might no longer be there. Accompanied by her lawyer she went to see Reynolds at the offices of CIBC in Grand Cayman on August 23rd, 1990. He told her that in January 1990 he had transferred money from the account of Newport Ltd. on the verbal instructions of Dupre without informing her. She instructed Reynolds to transfer the Newport Ltd. shares held by CMS to another management company. She received a letter from CIBC dated September 6th, 1990 stating her instructions were ineffective.

The statement of claim was filed in February 1991. The appellant was the plaintiff and it is not in dispute that it was a "derivative" action filed by the appellant not to obtain remedies for herself but rather for the company Newport Ltd. in which she held shares beneficially through the nominee CMS jointly with Dupre. Newport Ltd. was named as a defendant.

An application was filed on behalf of Reynolds to have the statement of claim struck out on the ground that it disclosed no cause of action. In effect, the contention was that the wrong allegedly suffered had been suffered by Newport Ltd. which alone could sue and that the plaintiff could not file a claim on behalf of Newport Ltd. unless it could be shown that the case fell within one of the exceptions to the rule in *Foss* v. *Harbottle* (9).

In *Edwards* v. *Halliwell* (5) Jenkins, L.J. restated that rule thus ([1950] 2 All E.R. at 1066):

> "The rule in *Foss* v. *Harbottle* . . . as I understand it, comes to no more than this. First, the proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is *prima facie* the company or the association of persons itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company or association and on all its members by a simple majority of the members, no indivudual member of the company is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company or association is in favour of what has been done, then *cadit quaestio*. No wrong had been done to the company or association and there is nothing in respect

> of which anyone can sue. If, on the other hand, a simple majority of members of the company or association is against what has been done, then there is no valid reason why the company or association itself should not sue."

5 It was also contended that even before the rule itself came to be considered, the appellant lacked the status to sue because she was not a member of the company, Newport Ltd. The register of shareholders showed that all the shares in that company were held by CMS. Section 37 of the Companies Law (Revised) 10 identified as members of a company those persons whose names appeared in the register. In *Birch* v. *Sullivan* (2) the plaintiff had been adjudicated a bankrupt and a trustee in bankruptcy had been appointed. His name still appeared on the register of members of a company in which he held shares. He issued a writ 15 against Sullivan who was a director of the defendant company claiming declarations for misfeasance as a director. The action was stayed so long as the plaintiff remained on the record as the plaintiff. Liberty was granted to have the action dismissed if the trustee in bankruptcy did not apply to be substituted as plaintiff 20 within a fixed time.

The Chief Justice rejected the submission that the appellant had no *locus standi*. He relied on a statement in *Bagshaw* v. *Eastern Union Ry. Co.* (1) that the holder of a "scrip" in a company had an "inchoate right to become a registered holder of 25 the perpetual stock" and for that reason could sue on its behalf. It was emphasized in that case (7 Hare at 130; 68 E.R. at 53) that it was not argued that—

> "the holders of scrip certificates in the perpetual stock had not such an interest in the application of the capital of the 30 company as was necessary to enable them to maintain a bill properly framed, to prevent a misapplication of the capital of the company."

The only issue was whether such persons could represent both scrip holders and holders of regular stock. The statement was, 35 therefore, *obiter* and was made without the benefit of argument.

There is some further support in *Stena Fin. BV* v. *Sea Containers Ltd.* (16). In that case, however, the plaintiff had become a registered shareholder by the date of hearing. The authority cited, *Great W. Ry. Co.* v. *Rushout* (10), had decided 40 that the beneficial owner of shares could sue if he joined the registered shareholder as a defendant.

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In this case, however, there is an additional complication. The plaintiff, though a beneficial owner, is a joint beneficial owner with Dupre. It is clear law that although as between themselves joint tenants and joint owners had separate rights, as against everyone else they were in the position of a single owner. There was absolute unity between them. Together they formed one person and could not commence proceedings without the aid of the other or others. As regards joint shareholders this principle was recently restated by Harman, J. in *Re Exchange Travel (Holdings) Ltd.* (7) ([1991] BCLC at 735) to the effect that—"joint tenants of a share are joint covenanters and can only act together. . . ." This suit is, therefore, not properly constituted in the absence of CMS and Dupre as plaintiffs. Neither would, of course, consent to be joined as plaintiffs. Consequently, they should have been named as defendants.

The substantive issue in this appeal is the correctness of the conclusion by the Chief Justice that wrongdoers cannot be held to have committed a "fraud upon the minority" within the meaning of the exception to the rule in *Foss* v. *Harbottle* (9) as stated above unless the wrongdoers have used their powers to benefit themselves. Mr. Lamontagne's submission was that where the acts of wrongdoers which result in loss to the company were merely negligent then personal gain to themselves must be proved to make applicable the exception to the rule in *Foss* v. *Harbottle*. Where, however, fraud on the part of the wrongdoers has been proved the element of personal gain from the fraud need not be established. Whilst it was not contended that Reynolds received any personal benefit from paying out money in the account of Newport Ltd. to Dupre, it was urged that his act was plainly a misappropriation of the company's funds which was intentional and could be categorized as "fraud."

Mr. Lamontagne's submission, in my view, proposes an extension of the principles enunciated in the authorities. In his judgment in *Prudential Assur. Co. Ltd.* v. *Newman Indus. Ltd. (No. 2)* (15) Vinelott, J. summarized the authorities in these words ([1980] 2 All E.R. at 869):

> "Thus the authorities show that the exception applies not only where the allegation is that directors who control a company have improperly appropriated *to themselves* money, property or advantages which belong to the company or, in breach of their duty to the company, have diverted business

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to themselves which ought to have been given to the company, but more generally where it is alleged that directors, though 'acting in the belief that they were doing nothing wrong' (per Lord Lindley, M.R. in *Alexander v. Automatic Telephone Co.* [1900] 2 Ch. 56 at 65) are guilty of a breach of duty to the company (including their duty to exercise proper care) and as a result of that breach obtain some benefit. In the latter case it must be unnecessary to allege and prove that the directors in breaking their duty to the company acted with a view to benefiting themselves at the expense of the company; for such an allegation would be an allegation of misappropriation of the company's property [Emphasis supplied]."

It will be noted that the reference to "improper appropriation" is followed by the qualification "to themselves" and that the distinction between negligence and fraud is based on proof of an intention on the part of the directors to benefit themselves when they acted in the negligent manner alleged.

In *Estmanco (Kilner House) Ltd.* v. *G.L.C.* (6) the company concerned was a non-profit company and no issue of monetary gain arose. All but 12 of the shares in the company were owned by the Greater London Council. The Council had set the company up to manage a block of 60 flats, Kilner House, which it owned. The Council intended to sell the flats on long lease to tenants. On the purchase of a flat, the purchaser would receive a share in the company but the right to cast a vote in respect of that share at meetings of the company would be exercisable only when all the flats had been sold and all the shares issued. Under this arrangement 12 flats had been sold and 12 shares issued when a change in control of the Council led to a change in policy. The Council no longer wished to sell the flats. It wished to let them to applicants on the housing list. The company, though controlled by the Council, sued the Council to restrain it from disposing of the unsold flats except on long lease in accordance with the agreement. The Council, using its voting power, ordered the directors to discontinue the action. The holder of one of the allotted shares sought leave to be substituted as a plaintiff suing on behalf of the company and to have the company named as a defendant.

Megarry, V.-C. granted the order prayed. He accepted as correct the principle formulated by Templeman, J. in *Daniels* v.

Daniels (4) after an analysis of the case. He said ([1982] 1 All E.R. at 445):

> "The principle which he derived from the cases was that 'a minority shareholder who has no other remedy may sue where directors use their powers, intentionally or unintentionally, fraudulently or negligently, in a manner which benefits themselves at the expense of the company' (see [1978] 2 All E.R. 89 at 96 . . .). Apart from the benefit to themselves at the company's expense, the essence of the matter seems to be an abuse or misuse of power."

Clearly the phrase "which benefits themselves at the expense of the company" is intended to apply to action on the part of the parties whether fraudulent or negligent. This was certainly the view taken by the Court of Appeal for Jamaica in *Tele communications of Jamaica Ltd.* v. *Bernard* (17) which, with respect, seems correct.

The facts of this case do not establish any personal advantage to Reynolds in the payment out to Dupre of the funds in the account of Newport Ltd. and accordingly the facts do not fit into the exception to the rule in *Foss* v. *Harbottle* (9).

There is the further issue as to whether the alleged "wrongdoers" control Newport Ltd. The exceptions to *Foss* v. *Harbottle* are based on the premise that the wrongdoers control the company and use their power of control to prevent themselves being sued. Mr. Lamontagne concedes, as indeed he must, that it cannot be contended that Reynolds controls Newport Ltd. He is one of five directors and he holds no shares. All the shares are held by CMS which has not been joined as a defendant. CMS itself is a wholly-owned subsidiary of CIBC.

In *Kuwait Asia Bank E.C.* v. *National Mutual Life Nominees Ltd.* (11) the Privy Council decided that nominee directors, in the exercise of their duties as directors, were bound to ignore the interests of the persons who had nominated them or who employed them. Their duty was to act in the best interests of their company. Reynolds would be under no obligation to heed the wishes of CIBC in this matter.

The application of these established principles to "offshore" companies managed by directors who have been appointed solely for the purpose of carrying out the wishes of the beneficial owners to whom the company really belongs must inevitably result in contradictions. The advantages of anonymity which beneficial

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owners perceive as accruing from these arrangements may well carry with them concealed problems.

While reality has to be taken into account in deciding control, in the sense that a tally may have to be made of the votes held by 5 the wrongdoers and the votes they may be able for one reason or another to control, legal principles cannot be ignored. The shares in Newport Ltd. were held by CMS. It controlled that company by reason of its having the power to dismiss all the directors and to replace them. Reynolds and his co-directors would be under a 10 legal obligation to act independently in the interests of Newport Ltd. No doubt if they sought to sue, CMS (like the Greater London Council in the *Kilner House* case (6)) could use its power to order discontinuance of any such action, though in this case there might be difficulties if CMS gave due heed to the 15 instructions of both joint beneficial shareholders.

The statement of claim as originally filed is thus defective in three important respects, namely (a) the appellant, as plaintiff, lacks the capacity as one of two joint shareholders to sue alone and has not named her co-owner as a defendant; (b) there are no 20 facts pleaded to establish that Reynolds gained any benefit from his alleged breach of trust or wrongful exercise of authority vis-a-vis the company; and (c) it erroneously avers that Reynolds and/or the directors of Newport Ltd. control Newport Ltd. when in fact legal control was vested in CMS which is not named as a defendant.

25 The first defect is concerned solely with the failure to have proper parties before the court. It could be remedied by an amendment and would not justify striking out the action.

The second defect is more fundamental. Guarding against the possibility that the submission might succeed, Mr. Lamontagne 30 sought, before opening the appeal, to apply for an amendment, the granting of which he contended would remedy the defect. The amendment consisted of the addition of an entirely new para. 27 to the statement of claim which read:

> "Further and in the alternative, Reynolds, CIBC and 35 Dupre have conspired together and with each other to deprive Newport, by the unlawful means set out in paras. 20, 21, 22, 23, 25 and 26 hereof, of the funds held in its account with CIBC and to transfer the said funds to Dupre by the said unlawful means."

40 Mr. Alberga submitted that the court had no jurisdiction to grant the amendment prayed since the statement of claim had

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been struck out by the Chief Justice so that there was no document which could be amended. That argument is, in my view, misconceived. Once an appeal has been filed, the dispute decided at the first instance hearing remains open for any action 5 which the appellate tribunal thinks necessary in the proper exercise of its powers. There is no basis for the distinction sought to be made between an action dismissed on the merits and an action which fails on the ground that the statement of claim discloses no cause of action and is, for that reason, struck out. It 10 is conceded that this court has all the powers of the Grand Court in relation to amendments and the Grand Court could certainly have granted the amendment sought had the application been made there and had the court exercised its discretion favourably. However, while the court does have the power, I see no 15 good reason for exercising it in favour of the appellant in this case.

The reason stated in the affidavit for not including the conspiracy claim in the original pleading was the view held by counsel that a claim for conspiracy could not succeed unless the 20 sole or dominant purpose was to harm the plaintiff. This was based on a decision of the Court of Appeal in *Metall & Rohstoff AG* v. *Donaldson, Lufkin & Jenrette Inc.* (14) in which Slade, L.J. so interpreted passages in a speech of Lord Diplock in *Lonhro Ltd.* v. *Shell Petroleum Co. Ltd.* (13). There was no 25 appeal in the *Metall* case but subsequent to the filing of the statement of claim in this matter the House of Lords in *Lonhro PLC* v. *Fayed* (12) held that this interpretation was not acceptable. There seems to be no good reason why the interpretation placed by the Court of Appeal on Lord Diplock's 30 judgment should not have been challenged in the courts of Grand Cayman.

I have difficulty in quieting the suspicion that the plea of conspiracy became important when it became clear that the need to allege personal benefit to the wrongdoer might be accepted as 35 crucial. The allegation of a conspiracy could arguably fulfil that need. It would be correct also to say that the allegation raised in the amendment is vague. Accordingly, I would refuse the application to amend at this stage. In any event much recasting of the statement of claim would be needed to cure the defect arising 40 from the failure properly to identify the wrongdoers in control of the company.

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Mr. Lamontagne stressed that the justice of the case required that some method be found to facilitate Newport Ltd. in remedying the wrong which it had suffered. The fact is that Newport Ltd. was a mere shell. The person who in fact suffered, if the allegations are correct, would be the appellant. There would appear to be far simpler courses of action open to her should she wish to claim remedies for the wrongs suffered.

Accordingly, I would dismiss the appeal with costs to the respondent to be agreed or taxed.

KERR, J.A.: I have had the benefit of reading the draft judgment of Georges, J.A. and am in agreement with his reasoning and his conclusion that the appeal should be dismissed with costs to the respondent to be agreed or taxed.

With respect to the application on behalf of the plaintiff/appellant to amend the statement of claim, I agree that having regard to the nature of the amendment sought, it would be clearly unfair to the respondent to entertain the application at this late stage. I am in agreement with the observations of Zacca, P. in his judgment to the effect that the amendment sought to be introduced by the application may be pursued by fresh and independent proceedings.

Appeal dismissed and amendment refused.

Attorneys: *C.S. Gill & Co.* for the plaintiff/appellant; *Hunter & Hunter* for the first defendant/respondent.

Case No: HC10C04093

Neutral Citation Number: [2011] EWHC 2287 (Ch)
IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 07/09/2011

Before :

MR JUSTICE NEWEY

- -

A DERIVATIVE CLAIM BETWEEN:

ANTHONY KLEANTHOUS	**Claimant**
- and -	
(1) THEODOROS PAPHITIS	**Defendants**
(2) MALCOLM STANLEY COOKE	
(3) RICHARD EDWARD TOWNER	
(4) IAN MICHAEL CHILDS	
(5) RYMAN GROUP LIMITED (formerly CHANCEREALM LIMITED)	
(6) RYMAN LIMITED	

- -

Mr Richard Keen QC and Mr Andrew Hunter (instructed by **Jones Day**) for the **Claimant**
Mr Neil Kitchener QC and Mr Sam O'Leary (instructed by **Mishcon de Reya**) for the **First Defendant**
Mr Richard Snowden QC and Mr Ben Shaw (instructed by **Reed Smith LLP**) for the **Second, Third and Fourth Defendants**
Mr Michael Todd QC and Miss Mary Stokes (instructed by **Ashurst LLP**) for the **Fifth and Sixth Defendants**

Hearing dates: 5-8 July 2011

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

....

Mr Justice Newey :

1. The Claimant, Mr Kleanthous, is a shareholder in Ryman Group Limited ("RGL"), the Fifth Defendant. By the application before me, he seeks permission under section 261 of the Companies Act 2006 to continue a derivative claim on behalf of RGL and one of its subsidiaries, Ryman Limited ("RL"), which is the Sixth Defendant.

2. The claim which Mr Kleanthous wishes to pursue arises out of the acquisition by Xunely Limited ("Xunely") of La Senza plc ("La Senza") in 1998. Xunely's owner, Mr Paphitis (the First Defendant), was (and is) also a director of RGL and the company's principal shareholder. In the present proceedings, Mr Kleanthous alleges that the acquisition of La Senza involved breaches of fiduciary duty on the part of Mr Paphitis and three other directors of RGL: the Second, Third and Fourth Defendants, respectively Mr Cooke, Mr Towner and Mr Childs. I shall refer to Messrs Paphitis, Cooke, Towner and Childs collectively as "the Director Defendants".

Basic facts

3. In 1998, RGL, which was then called "Chancerealm Limited", had three subsidiaries. One of these, RL, carried on a well-known stationery business. A second subsidiary, Contessa (Ladieswear) Limited ("Contessa"), had a lingerie business. The third subsidiary, NAG Communications Limited, had a mobile telephone business.

4. RGL's shareholders were Mr Kleanthous, Mr Paphitis and Mr Childs. Mr Paphitis was much the largest shareholder, with 72.4% of the shares. Mr Kleanthous and Mr Childs respectively held 15.5% and 12.1% of the shares.

5. RGL's board included two of its three shareholders: Mr Paphitis and Mr Childs. The other members of the board were Mr Cooke, Mr Towner and a Mr Ring. Mr Kleanthous was not a director. He had entered into a shareholders' agreement in 1996 under which he had undertaken that he would hold his shares for investment purposes only and would not:

> "participate in or influence the affairs of [RGL] or any of its subsidiaries or seek or be entitled to any information in respect of the day-to-day management of [RGL] other than information available to all shareholders as prescribed by law".

6. Mr Paphitis is one of the "dragons" on the well-known television programme "Dragons' Den" and has a high public profile. Mr Childs has a background in marketing and was co-founder with Mr Paphitis of Movie and Media Sports Limited, a business which, Mr Childs says, occupied most of his time in 1998. For his part, Mr Cooke has many years' experience of senior management, especially in retail; he was a director of RL before Mr Paphitis became involved with it. Mr Towner is a solicitor and was a partner in Richards Butler (later to be incorporated into Reed Smith) until he retired in 1992; he is a non-executive director of RGL and RL ("the Ryman Companies"). In 1998, Mr Cooke and Mr Towner each had share options in RGL.

7. At the beginning of 1998, Suzy Shier, a retailer in Canada and the United States, owned through Suzy Shier Equities Inc, a wholly-owned subsidiary of Suzy Shier

Limited, 60.2% of the issued share capital of La Senza. La Senza carried on a lingerie business and was listed on the London Stock Exchange's AIM market.

8. By early 1998, Suzy Shier was looking for buyers for its shareholding in La Senza. According to Mr Paphitis, he was approached about La Senza in February or March of 1998 and subsequently discussed with other directors of RGL the possibility of becoming involved with La Senza. Both Mr Paphitis and the other Director Defendants say that it was decided that it would not be appropriate for RGL to acquire La Senza.

9. Mr Paphitis says that he was approached about La Senza again at the beginning of June 1998. On this occasion, Mr Paphitis explains, Suzy Shier offered to sell its shares in La Senza for just £1 subject to the provision of an indemnity in respect of certain ongoing liabilities of La Senza, which largely related to equipment leases. According to Mr Paphitis, he and his fellow directors remained of the view that RGL should not undertake the acquisition, but he decided (with the blessing of other directors) that he would like to take on La Senza in a personal capacity. The evidence of the other Director Defendants is to broadly similar effect.

10. Matters came to a head during the night of 3-4 June 1998, during which there were negotiations which ultimately led to Mr Paphitis agreeing to buy Suzy Shier's shares in La Senza through Xunely, a newly-acquired shelf company. In the course of these negotiations, Mr Paphitis asked Mr Cooke, Mr Towner and Mr Ring whether they would agree to RGL lending Xunely the funds (some £1.4 million) required to buy the shares in La Senza held by shareholders other than Suzy Shier (Suzy Shier having apparently called for proof of Mr Paphitis' ability to fund the purchase of these shares) and giving a guarantee in respect of Suzy Shier's exposure to liabilities of La Senza (Suzy Shier having apparently stated that a third party guarantee was required).

11. In Mr Cooke's words, "[a] board meeting was convened between those directors [of RGL] present in the meeting room at Gouldens' offices". Mr Towner wrote out minutes of this meeting in manuscript. These recorded that Mr Paphitis, Mr Cooke and Mr Towner were present and that Mr Ring, who was "unavoidably absent but had participated in negotiations", was in agreement. The minutes stated that it had been resolved that:

    i) A loan of up to £1.8 million should be made to Xunely to finance its acquisition of La Senza at an interest rate of 3% above base rate and with security over Xunely's assets;

    ii) A guarantee should be given in respect of "the possible liability of La Senza to Suzy Shier Limited on terms to be agreed by the Board";

    iii) A management agreement should be entered with Xunely on terms to be agreed.

The minutes went on to record that the board members present "confirmed that in their opinion the matters, having been discussed in detail, were of commercial benefit to [RGL]". However, in the course of submissions Mr Neil Kitchener QC, who appears with Mr Sam O'Leary for Mr Paphitis, accepted that Mr Childs had not been

given notice of the 3 June "board" meeting and so that it could not have constituted a valid board meeting.

12. It seems that it was also that evening that Mr Cooke and Mr Towner became directors of Xunely, as did Mr Ring. Mr Cooke and Mr Towner were later to acquire share options in Xunely, but not, it seems, until late 2001. Thereafter, Mr Cooke and Mr Towner respectively had share options of 7.62% and 3.55% in RGL and 7.5% and 2.55% in Xunely. Mr Childs has never held shares or share options in Xunely nor been a director of the company.

13. On 4 June 1998, an agreement was entered into under which, among other things, Xunely agreed (a) to buy Suzy Shier Equities Inc's shares in La Senza for £1 and (b) to indemnify Suzy Shier companies in respect of guarantees they had given in relation to La Senza. Further, RGL covenanted that it would procure that Xunely performed its obligations under the agreement and, in particular, would pay Suzy Shier any sums which Xunely failed to pay.

14. Mr Childs says that he recalls being told by Mr Paphitis during the morning of 4 June 1998 that he had bought La Senza. Mr Paphitis says that he told Mr Childs that day that Mr Cooke, Mr Towner and Mr Ring had accepted appointments as directors of Xunely.

15. In the following days, there were press reports about Xunely's acquisition of La Senza. The Independent, for example, reported on 5 June 1998 that:

> "Suzy Sher Equities [had] sold its 60 per cent controlling stake for a token pounds 1 to Xunely, a newly created company controlled by Theo Paphitis and his family, the owners of Rymans the stationers and Contessa Ladieswear".

The Financial Times referred in an article dated 18 June 1998 to "Financial support from a company associated with its prospective new owner" having enabled La Senza to continue trading.

16. On 15 June 1998, there was a board meeting of RGL. This was attended by Mr Paphitis, Mr Cooke, Mr Childs and Mr Ring. The minutes contained the following account of events:

> "The Chairman [i.e. Mr Paphitis] confirmed that he had discussed with members of the Board the possible acquisition of La Senza by Chancerealm [i.e. RGL] but a decision had been reached that, in view of the extremely parlous financial situation of La Senza it would not be sensible to acquire that company and bring it with[in] the Chancerealm group. Whilst Mr Paphitis, having discussed a number of issues relating to that acquisition with Mr Ring and Mr Cooke, was confident that the situation could be turned round, if the financial figures of La Senza were incorporated in the Chancerealm Group profits at this time it would have a damaging effect on the Chancerealm Group profits notwithstanding that the shareholders' value in the Group is represented by the trading

> performance of each individual subsidiary. However in order to ensure that no reduction in Group profits (and hence perception of the Group's performance) occurred as a result of the introduction of La Senza into the Group it had been agreed that a special purpose company, owned by Mr Paphitis, should acquire the La Senza shares. However the activities of La Senza and its product, and outlets would be complementary to the products and outlets of Contessa (Ladieswear) Limited and benefits would accrue to the Chancerealm Group by the provision of management and administrative services (on an arm's length basis for which it would be properly remunerated) by La Senza and by the utilisation of surplus warehouse and office space at Hayes by La Senza (again for which La Senza would pay an arm's length fee).
>
> The association would also result in increased buying power and probable resultant discounts and purchasing terms from suppliers, reduced overheads (because of shared facilities deliveries to outlets and so on) and for the relevant services it was proposed that La Senza would pay on an arm's length basis."

After recording that the board "had considered that it was in the interests of the company to enter into the arrangements relating to the loan and to the provision of the guarantee", the minutes stated:

> "All those present confirmed their agreement with the above matters and it was noted that Richard Towner, who had expressed apologies for his absence from the meeting, had been present at the Board meeting held on 3rd June and had agreed with the various matters therein dealt with. Furthermore discussions had taken place between the Chairman, Mr Ring and Richard Towner with regard to the various issues now discussed at this Board Meeting and Mr Towner had expressed his agreement with them".

The minutes proceeded to record, among other things, that a form of loan agreement had been approved. They also stated:

> "It was noted that in order to enable the auditors to La Senza Plc to sign off the Accounts for the year ended 31st January 1998, the Company had provided a letter confirming the discussions held with the Directors and advisers of La Senza Plc on 3rd June 1998 that the Company would provide or procure such financial support as is reasonable and necessary to enable La Senza Plc to continue trading".

17. Also on 15 June 1998, Mr Ring wrote on behalf of RGL to confirm that it would "procure or provide such financial support as is necessary and reasonable to ensure that La Senza plc is able to continue trading and meet its commitments as they fall

due". On 16 June, RGL formally offered to lend Xunely up to £1.8 million to enable it to make an offer for all the issued shares in La Senza not already owned by Xunely.

18. Minutes of a further board meeting of RGL, on 23 June 1998, recorded agreement to provide United Mizrahi Bank Limited with a guarantee, limited to £2 million, which the Bank required in support of a trade finance facility provided to La Senza.

19. There was reference to arrangements between Xunely and RGL in a circular distributed in the second half of June 1998 to shareholders of La Senza (who, however, did not include Mr Kleanthous). In particular, a letter included in the circular had a passage in these terms:

> "Xunely has entered into an agreement with Chancerealm [i.e. RGL] whereby Chancerealm has committed to lend to Xunely up to £1.8 million for the purpose of financing the Offer …. Furthermore, Chancerealm has guaranteed the performance by Xunely of the indemnity given by Xunely to Suzy Shier referred to above. It is proposed that Xunely and La Senza will enter into a management agreement with Chancerealm whereby Chancerealm will provide management services for the operation of the La Senza business".

The letter identified Mr Paphitis, Mr Cooke, Mr Towner and Mr Ring as directors of both Xunely and RGL.

20. Mr Kleanthous evidently saw some of the press coverage relating to the sale of La Senza. In a letter to Mr Towner dated 11 August 1998, he said:

> "A short while ago I spoke with Theo [Paphitis] regarding press reference to the purchase of the La Senza Canadian Lingerie chain. I would appreciate any information you are able to provide on how this purchase effects the strategy of the Chancerealm [i.e. RGL] Group".

Replying on the following day, Mr Towner said:

> "So far as concerns La Senza, the purchase was by Xunely Limited, a company wholly owned by Theo and I think that any queries as to how this relates to or affects the strategy of the Chancerealm Group were best directed at Theo".

Two days later, Mr Kleanthous wrote to Mr Paphitis enclosing a copy of Mr Towner's letter. In his letter, Mr Kleanthous said:

> "Regarding his second paragraph [i.e. the passage from Mr Towner's letter quoted above], I should be interested in your comments. When I first learned about the purchase of La Senza a few months ago, I had assumed it was a Chancerealm deal since presumably La Senza is a similar line of business to Contessa".

Responding on 17 August, Mr Paphitis said this:

> "Further to your letter dated 14 August 1998, I am somewhat surprised with the second paragraph since you and I have had 2 telephone conversations subsequent to the purchase of La Senza. At the time of the calls, I made the situation absolutely clear and explained to you that this was not purchased by Chancerealm Ltd and it was not a Chancerealm deal which you fully understood and accepted.
>
> I am not going to labour on in order to remind you word for word about the conversation, or get involved in any lengthy correspondence to this end, but as always it will be a pleasure to get together with you should you wish, and answer any questions which you may have with regards to Chancerealm or La Senza face to face".

21. Mr Kleanthous wrote back to Mr Paphitis on 27 August 1998. His letter included these paragraphs:

> "After I read the press comment about the purchase of La Senza, I did raise the matter with you and, while I understood what you told me, it is not correct to say that I accepted the situation.
>
> Indeed, given the similarity of this business with that of Contessa, I was keen to establish how you would propose to deal with the apparent conflict of interest".

Mr Paphitis does not appear to have replied. Neither does Mr Kleanthous seem to have pursued Mr Paphitis' suggestion of a face-to-face meeting.

22. The Ryman Companies' accounts for the year ended 27 March 1999, which were filed at Companies House in April 2000, contained references to the companies' support for Xunely and La Senza. The note to RGL's accounts dealing with related party transactions explained that the figure given for "other debtors" of RGL included "£1,398,076 owed by La Senza Limited, this balance having arisen as a result of cash transfers having been made to La Senza Limited" and "£146,338 owed by Xunely Limited … as a result of the payment of professional fees on behalf of Xunely Limited". It was further explained that the figure given for "other debtors" of the group included £1,443,340 owed by Xunely "as a result of the payment of professional fees on behalf of Xunely Limited and as a result of cash transfers to Xunely Limited". There was reference, too, to the group having "made a management charge of £625,000 to La Senza Limited to cover warehouse, transport and other associated costs borne by the group on behalf of La Senza Limited". Another note stated that RGL "guarantees the trade finance facility of La Senza".

23. In late 2001, Contessa was de-merged. Contessa was, as I understand it, transferred to a new holding company whose shareholdings corresponded to RGL's. Mr Cooke explains in his witness statement that it was thought sensible for RGL to focus exclusively on stationery. At this stage, Mr Kleanthous through his then solicitor

acknowledged that there had been no breach of duty by RGL's directors "as far as he [was] aware".

24. In similar vein, in 2002 Mr Kleanthous countersigned a letter to confirm that, so far as he was aware, he had no claim against his fellow shareholders or directors "suggesting any breach of fiduciary obligations or anything improper in the operations of any of [the companies in the RGL and La Senza groups]".

25. Xunely declared dividends in favour of Mr Paphitis of some £2.7 million in 2004 and £4 million in 2006.

26. In 2006, Xunely sold 90% of its shares in La Senza to a private equity group called Lion Capital for more than £100 million.

27. Later in 2006, Contessa was also sold to Lion Capital. According to Mr Kleanthous, the price to be paid was over £8 million but was to be reduced to about £5.5 million after deduction of a debt owed to RGL. Following its sale, 47 of Contessa's shops seem to have become La Senza shops while the remaining 18 were apparently closed.

28. In a letter dated 26 February 2010, Mr Kleanthous' solicitors informed Mr Paphitis and the directors of the Ryman Companies that Mr Kleanthous was proposing to bring a claim by way of derivative action against Mr Paphitis, RGL and RL. At this stage, it was not suggested that the proposed claim would extend to Mr Cooke, Mr Towner or Mr Childs. It was, however, said that Mr Cooke, Mr Towner and Mr Childs were "not independent" and that "it should have been apparent to them that the conduct of Mr Paphitis was wrongful". Subsequently, after correspondence with solicitors instructed on behalf of, respectively, Mr Paphitis and the other directors of RGL and RL, Mr Kleanthous widened the ambit of the proposed derivative claim to encompass allegations against Mr Cooke, Mr Towner and Mr Childs.

29. The proceedings which are now before me were issued on 29 November 2010. On the same day, Mr Kleanthous applied for permission under section 261 of the Companies Act 2006 to continue his derivative claim. On 21 December 2010, Floyd J gave directions in relation to the application to continue the derivative claim. The directions provided, among other things, for the various Defendants to be made Respondents to Mr Kleanthous' application and for the Defendants to file and serve evidence in answer to it.

30. The board of RGL now comprises Mr Paphitis, Mr Cooke, Mr Towner, Mr Childs, Mr Kypros Kyprianou ("Mr Kyprianou") and Mr Simon Lakin ("Mr Lakin"). Mr Kyprianou joined the RGL group in 2004. Mr Lakin became a director of RGL in 2008, having previously been an employee since 2001.

31. On 17 February 2011, the boards of RGL and RL each resolved to set up a committee, to consist of Mr Kyprianou and Mr Lakin, to seek professional advice and make decisions in relation to the present proceedings. On 3 March, the committees resolved that RGL and RL should not bring or continue the claim brought derivatively by Mr Kleanthous. The minutes of each meeting included this:

> "After careful consideration the directors concluded that:

(a) the negative effect on the Company's businesses of the Company bringing or continuing a claim against the Defendant Directors greatly outweighs any benefit to the Company by pursuing the claim; and

(b) bringing or continuing the claim against the Defendant Directors would not promote the success of the Company".

32. Mr Kleanthous' case is summarised as follows in the Particulars of Claim:

"In summary, as set out in more detail below:

9.1 As directors of RGL and Ryman [i.e. RL], the Director Defendants owed fiduciary obligations to RGL and Ryman, which amongst other things required them not to use company assets for their own benefit or for that of associated companies and not to divert business opportunities from RGL or Ryman.

9.2 From about June 1998 onwards, the Director Defendants committed serious and fraudulent breaches of these fiduciary duties:

9.2.1 the Director Defendants diverted a substantial business opportunity (namely the purchase of the company and lingerie business, La Senza) away from RGL and Ryman in order to develop this opportunity for the benefit of Pahitis and his company Xunely (in which Cooke and Towner were also interested);

9.2.2 the Director Defendants used the assets of RGL and/or Ryman for their own benefit and/or that of Paphitis' company, Xunely, by procuring RGL and/or Ryman: (1) to make loans to Xunely in order to purchase La Senza; (2) to fund La Senza's activities after the acquisition, and (3) to provide a trade finance facility for La Senza;

9.2.3 the Director Defendants failed to disclose their own breaches of duty to the independent shareholder of RGL and/or Ryman, namely AK.

9.3 Paphitis (acting on his own behalf and for Cooke, Towner and Childs) deliberately concealed the wrongful conduct and breaches of duty from AK [i.e.

Mr Kleanthous], being the independent shareholder of RGL and Ryman.

9.4 By reason of the said matters, the Director Defendants have made very substantial profits (in excess of £120 million) and have caused enormous loss to RGL and Ryman.

9.5 RGL and Ryman remain under the control of the Director Defendants who have refused to permit these companies to commence proceedings in respect of the wrongdoing committed by them.

9.6 By reason of the matters aforesaid, it is appropriate for this claim to be brought as a derivative action. RGL and Ryman are entitled to remedies against the Director Defendants including declarations of trust and/or an account of profits or equitable compensation."

33. Mr Kleanthous now asks, first, for permission to continue the claim on behalf of RGL and RL and, secondly, to be indemnified by RGL and RL in respect of costs. The Defendants all oppose the grant of any such relief.

The legal framework

Part 11 of the Companies Act 2006

34. The circumstances in which a derivative claim can be brought are nowadays dealt with in Part 11 of the Companies Act 2006. As regards England and Wales, the relevant provisions are sections 260-264.

35. Section 261(1) of the 2006 Act stipulates that a member of a company who brings a derivative claim must apply to the Court for permission to continue it. If it appears to the Court that the application and the evidence filed in support of it do not disclose a prima facie case for giving permission, the Court must dismiss the application (section 261(2)). If, on the other hand, the application is not dismissed at this stage, the Court may "give directions as to the evidence to be provided by the company" and adjourn the application to enable the evidence to be obtained (section 261(3)). On hearing the application, the Court may (under section 261(4)):

"(a) give permission … to continue the claim on such terms as it thinks fit,

(b) refuse permission … and dismiss the claim, or

(c) adjourn the proceedings on the application and give such directions as it thinks fit".

36. Section 263 is concerned with when permission to continue a derivative claim should be given. Sub-sections (2), (3) and (4) are in the following terms:

"(2) Permission (or leave) must be refused if the court is satisfied–

(a) that a person acting in accordance with section 172 (duty to promote the success of the company) would not seek to continue the claim, or

(b) where the cause of action arises from an act or omission that is yet to occur, that the act or omission has been authorised by the company, or

(c) where the cause of action arises from an act or omission that has already occurred, that the act or omission–

(i) was authorised by the company before it occurred, or

(ii) has been ratified by the company since it occurred.

(3) In considering whether to give permission (or leave) the court must take into account, in particular–

(a) whether the member is acting in good faith in seeking to continue the claim;

(b) the importance that a person acting in accordance with section 172 (duty to promote the success of the company) would attach to continuing it;

(c) where the cause of action results from an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be–

(i) authorised by the company before it occurs, or

(ii) ratified by the company after it occurs;

(d) where the cause of action arises from an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company;

(e) whether the company has decided not to pursue the claim;

(f) whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than on behalf of the company.

(4) In considering whether to give permission (or leave) the court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter".

37. Section 172 of the 2006 Act, to which there is reference in section 263, requires a director to act "in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole". In doing so, he is to have regard (amongst other matters) to:

> "(a) the likely consequences of any decision in the long term,
>
> (b) the interests of the company's employees,
>
> (c) the need to foster the company's business relationships with suppliers, customers and others,
>
> (d) the impact of the company's operations on the community and the environment,
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
>
> (f) the need to act fairly as between members of the company".

Section 263(2)(a)

38. Section 263(2)(a) of the 2006 Act will not apply merely because some, or even most, directors would not seek to continue the claim. In *Iesini v Westrip Holdings Ltd* [2009] EWHC 2526 (Ch), [2010] BCC 420, Lewison J explained the position as follows (in paragraph 86):

> "s.263(2)(a) will apply only where the court is satisfied that *no* director acting in accordance with s.172 would seek to continue the claim. If some directors would, and others would not, seek to continue the claim the case is one for the application of s.263(3)(b)".

No threshold

39. Mr Kitchener submitted that the Court should grant permission for a derivative claim to be continued only if satisfied that the Claimant has a strong case. In this connection, he relied on a passage from *Iesini v Westrip Holdings Ltd*. In paragraph 79 of his judgment in that case, Lewison J suggested that, for the Court to give permission for a derivative claim to be continued under section 261(4), "something more than a prima facie case" is required.

40. However, Part 11 of the 2006 Act does not in terms provide that a claim must reach a specific threshold if it is to be allowed to continue. Further, in *Stainer v Lee* [2010] EWHC 1539 (Ch), [2011] BCC 134, Roth J expressed the view (in paragraph 29) that section 263(3) and (4) "do not prescribe a particular standard of proof that has to be satisfied but rather require consideration of a range of factors to reach an overall view". Roth J went on:

> "In particular, under s.263(3)(b), as regards the hypothetical director acting in accordance with the s.172 duty, if the case seems very strong, it may be appropriate to continue it even if

> the likely level of recovery is not so large, since such a claim stands a good chance of provoking an early settlement or may indeed qualify for summary judgment. On the other hand, it may be in the interests of the company to continue even a less strong case if the amount of potential recovery is very large. The necessary evaluation, conducted on, as Lewison J observed, a provisional basis and at a very early stage of the proceedings, is therefore not mechanistic".

41. Roth J's observations are consistent with the Law Commission's intentions. In paragraph 6.72 of its report on shareholder remedies (number 246), on which the relevant provisions of the 2006 Act are to a considerable extent based, the Law Commission recommended that "there should be no threshold test on the merits". Roth J's views are in keeping, too, with comments made in a Scottish case, *Wishart v Castlecroft Securities Ltd* [2009] CSIH 65. Lord Reed, giving the opinion of the Inner House, there said (in paragraph 40):

> "[S]ection 268 [i.e. the Scottish equivalent to section 263] does not impose any threshold test in relation to the merits of the derivative proceedings. As we have explained, the Law Commission recommended that there should be no such test, partly in order to avoid the risk of a detailed investigation into the merits of the case taking place at the leave stage, and partly to avoid the drawing of fine distinctions based on the language of a particular rule. Section 268, and the parallel provision for England and Wales and Northern Ireland in section 263, do not depart from that recommendation. That is consistent with the nature of the factor to be considered under section 268(2)(b): it is possible to conceive of circumstances in which a director acting in accordance with section 172 might attach great importance to raising proceedings which were merely arguable, and of other circumstances in which a director might have sound business reasons for attaching little importance to raising proceedings which had good prospects of success."

42. In the circumstances, it seems to me that the Court can potentially grant permission for a derivative claim to be continued without being satisfied that there is a strong case. The merits of the claim will be relevant to whether permission should be given, but there is no set threshold.

The role of the Director Defendants

43. When opening the matter, Mr Richard Keen QC, who appears with Mr Andrew Hunter for Mr Kleanthous, queried what role the Director Defendants should be playing in the application. He pointed out that in *Wishart v Castlecroft Securities Ltd* the Inner House considered that directors against whom it was proposed that derivative proceedings be brought should not be allowed to take part in the application to continue the claim (see paragraph 26 of the opinion of the Court). The Court's reasons for arriving at that conclusion included, first, that the directors had "no interest in the proceedings as individuals (other than in the most general sense), by reason of being intended defenders in the derivative proceedings" (paragraph 19);

secondly, that, while the 2006 Act provides for evidence from the company, there "is no indication in sec 266 that the proposed defenders are intended to participate in the proceedings on the application" (paragraph 20); thirdly, that there "is nothing in the matters to be considered which suggests that it should ordinarily be necessary to hear the proposed defenders" (paragraph 20); and fourthly, that it "is not in the interest of the company … that the potential defenders in those proceedings should be given advance notice of weaknesses in the company's case and of documents and witnesses which would be helpful to their defence" (paragraph 23). Section 266 of the 2006 Act, which is concerned with derivative proceedings in Scotland, largely corresponds to section 261 of the Act.

44. Mr Keen did not go so far as to suggest that I should refuse to hear counsel for the Director Defendants. In any case, I consider that the Director Defendants were entitled to advance submissions to me. That must, I think, follow from the order made by Floyd J on 21 December 2010, which provided for the Director Defendants to be made Respondents to the application for permission to continue the derivative claim and to put in evidence in answer to the application. It seems to me, moreover, that it was appropriate for the Director Defendants to be permitted to participate in the permission application. In the first place, section 261 of the 2006 is not identical to section 266. In particular, while section 266 states that "the company is entitled to take part in the further proceedings on the application", section 261 says nothing about who is entitled to take part in the permission application. More importantly perhaps, where (as in the present case) the Claimant is seeking an indemnity as to costs, a Defendant who is a shareholder will have an interest other than merely as a person against whom it is intended that proceedings are brought. On the facts of the present case, an indemnity would be likely to mean that the Director Defendants stood, in practice, to bear the bulk of Mr Kleanthous' costs even if his claim were wholly unsuccessful. Further, while (as Mr Keen pointed out) proposed Defendants can be expected to be partisan, so can the Claimant. A Claimant will be in a very different position to that of, say, trustees seeking a *Beddoe* order, on whom it is incumbent to "make full disclosure of the strengths and weaknesses of their case" (see *Alsop Wilkinson (a firm) v Neary* [1996] 1 WLR 1220, at 1224). That leads to another point. A Court hearing a *Beddoe* application will commonly need to have access to privileged material. In contrast, there will normally be no question of a Court dealing with an application to continue derivative proceedings being offered access to privileged material, and there was no suggestion in the present case that I needed to see such material; participation in the permission application will not, therefore, have given the Director Defendants access to material which they could not otherwise have seen. It is also relevant to note that the modern tendency is to allow those with whom trustees are in litigation to participate as fully as possible in *Beddoe* applications. Thus, in *STG Valmet Trustees Ltd v Brennan* (1999) 4 ITELR 337, the Court of Appeal for Gibraltar said (at 351):

> "Claimants to the trust fund, whether they be beneficiaries or strangers to the trust, should be allowed the maximum opportunity of being heard on the application consistent with the need to maintain confidentiality on matters which properly arise for consideration between the trustee and the court alone".

The merits of the proposed claim

45. The merits of the proposed claim are of obvious relevance to the matters I have to decide. They have a bearing, in particular, on the factors specified in section 263(2)(a) and section 263(3)(b) of the 2006 Act. As Lewison J said in *Iesini v Westrip Holdings Ltd* (in paragraph 79), any view as to the strength of a claim "can only be provisional where the action has yet to be tried; but the court must … do the best it can on the material before it".

46. Argument about the merits of the claim ranged widely. I do not think I need rehearse all the points that were aired before me, but I shall sketch out some of the main issues.

47. Company directors, like other fiduciaries, are subject to "no conflict" and "no profit" rules. The effect of these was summarised in these terms by Deane J in the High Court of Australia in *Chan v Zacharia* (1984) 154 CLR 178:

> "Stated comprehensively in terms of the liability to account, the principle of equity is that a person who is under a fiduciary obligation must account to the person to whom the obligation is owed for any benefit or gain (i) which has been obtained or received in circumstances where a conflict or significant possibility of conflict existed between his fiduciary duty and his personal interest in the pursuit or possible receipt of such a benefit or gain or (ii) which was obtained or received by use or by reason of his fiduciary position or of opportunity or knowledge resulting from it."

48. In the present case, there is a strong case for saying that the "no conflict" and "no profit" rules were both potentially engaged. The decision of the Court of Appeal in *Bhullar v Bhullar* [2003] EWCA Civ 424, [2003] 2 BCLC 241 suggests that the "no conflict" rule is capable of applying if "the reasonable man, looking at the relevant facts and circumstances of the particular case, would think that there was a real sensible possibility of conflict", and the reasonable man might surely have taken that view in relation to Xunely's acquisition of La Senza. Mr Paphitis arguably had conflicts of both interest and duty as Xunely's owner and one of its directors. Mr Cooke and Towner can also be said to have had conflicts of duty once they had become directors of Xunely as well as of the Ryman Companies. The way in which the Ryman Companies facilitated Xunely's acquisition of La Senza points to the "no profit" rule applying as well.

49. One of the answers advanced by the Defendants is that the transaction was approved by RGL's board (in particular, at the board meeting on 15 June 1998). The Defendants rely in this context on RGL's articles of association, article 22 of which, at the relevant times in 1998, provided as follows:

> "A director may vote as a director in regard to any contract or arrangement in which he is interested or upon any matter arising thereout, and if he shall so vote his vote shall be counted and he shall be reckoned in estimating a quorum when any such contract or arrangement is under consideration and Regulations 94 to 97 in Table A [i.e. Table A in the Companies

> (Tables A to F) Regulations 1985] shall be modified accordingly".

Further, regulation 85 of Table A, which applied to RGL, was in the following terms:

> "Subject to the provisions of the Act [i.e. the Companies Act 1985], and provided that he has disclosed to the directors the nature and extent of any material interest of his, a director notwithstanding his office –
>
> (a) may be a party to, or otherwise interested in, any transaction or arrangement with the company or in which the company is otherwise interested;
>
> (b) may be a director or other officer of, or employed by, or a party to any transaction or arrangement with, or otherwise interested in, any body corporate promoted by the company or in which the company is otherwise interested; and
>
> (c) shall not, by reason of his office, be accountable to the company for any benefit which he derives from any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate and no such transaction or arrangement shall be liable to be avoided on the ground of any such interest or benefit".

50. There may be some scope for argument as to whether the Director Defendants sufficiently disclosed their conflicts of interest/duty to RGL's board. The minutes of the 15 June 1998 board meeting referred in terms to Mr Paphitis' ownership of Xunely, but nothing was said about the fact that Mr Cooke and Mr Towner had become directors of Xunely. Mr Paphitis has said in a witness statement that he told Mr Childs on 4 June 1998 that Mr Cooke, Mr Towner and Mr Ring had accepted appointments as directors of Xunely, but, even if that is right, it could be argued that one of the "provisions of the Act" had not been complied with and, hence, that the requirements of regulation 85 of Table A could not be satisfied as regards Mr Cooke and Mr Towner. The provision in question would be section 317 of the Companies Act 1985, which stipulated that a director of a company with an interest in a contract or proposed contract with the company had "to declare the nature of his interest at a meeting of the directors of the company". In the present case, Mr Cooke and Mr Towner do not appear to have declared their directorships of Xunely at a meeting of RGL's board. On the other hand, Mr Richard Snowden QC, who appears with Mr Ben Shaw for Mr Cooke, Mr Towner and Mr Childs, submitted that regulation 85's reference to the "the provisions of the Act" could not extend to section 317 of the 1985 Act since that would render the next words (viz. "and provided that he has disclosed to the directors the nature and extent of any material interest of his") otiose.

51. Mr Keen also challenged the RGL board's approval of Xunely's acquisition of La Senza on the basis that all members of the board, including Mr Childs, were conflicted. Mr Keen argued that Mr Childs was to be considered to have had a conflicting interest because he was a close business associate of Mr Paphitis. However, Mr Childs was never at any stage a director of Xunely, and he never had

either shares or share options in that company. On the face of it, his interests lay with RGL, of which he was both a director and a substantial shareholder. I doubt whether the mere fact that Mr Paphitis could be described as a close business associate could mean that Mr Childs had a relevant conflict of interest.

52. Be that as it may, Mr Keen submitted that the Director Defendants acted in conscious disregard of their duty to further the interests of the Ryman Companies and so fraudulently. Such conduct, Mr Keen argued, cannot be authorised or ratified by a board resolution. The minutes of the board meeting of 15 June 1998 represented, Mr Keen suggested, "little more than window dressing, for a clear and deliberate breach of the directors' fiduciary duties to RGL". The arrangements relating to the acquisition of La Senza involved, Mr Keen said, RGL taking all the risks for none of the reward. No one, Mr Keen maintained, could have believed the arrangements to be in RGL's interests.

53. As was pointed out in submissions, one of the matters put forward in the Particulars of Claim in support of the allegations of fraud and dishonesty is the proposition that "it was obvious and the Director Defendants were *or should have been* aware that each of them was acting in serious breach of his fiduciary duties" (my emphasis). The complaint that the Director Defendants "should have been aware" suggests negligence rather than fraud. However, Mr Keen said in submissions that the words "or should have been" were a mistake. The passage ought to have alleged knowledge/wilful blindness.

54. Mr Snowden was prepared to accept that regulation 85 of Table A will not have served to release the Director Defendants from their duties to act in their companies' interests (compare *Movitex Ltd v Bulfield* [1988] BCLC 104). However, he stressed, among other things, that it is a director's obligation to do what he *believes* to be in his company's interests (see e.g. *Regentcrest plc v Cohen* [2001] 2 BCLC 80, at paragraph 120). Both he and Mr Kitchener argued that, on the facts, the prospects of Mr Kleanthous establishing that the Director Defendants had acted otherwise than in what they believed to be the interests of the Ryman Companies were poor to non-existent. Among the more compelling of the matters which the Director Defendants advanced in this context were these:

i) Absence of motive. Mr Cooke and Mr Towner do not appear to have acquired significant financial interests in La Senza until several years later, and Mr Childs never had any obvious reason to act otherwise than in the interests of the Ryman Companies;

ii) The board minutes. These seem to confirm that the Director Defendants had the interests of the Ryman Companies in mind in June 1998, and showing them to be "little more than window dressing" would not be an easy task;

iii) The Director Defendants have put forward a number of reasons for not wanting RGL to acquire La Senza but being prepared to support Xunely's acquisition of it. They echo to a considerable extent points made in the minutes of the 15 June 1998 board meeting (see paragraph 16 above).

55. It was also submitted on behalf of the Director Defendants that any claim was statute-barred. Mr Keen argued otherwise on the basis that section 21(1)(a) of the Limitation Act 1980 and/or section 32 of that Act applied.

56. Section 21(1) of the 1980 Act provides as follows:

> "No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action—
>
> (a) in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy; or
>
> (b) to recover from the trustee trust property or the proceeds of trust property in the possession of the trustee, or previously received by the trustee and converted to his use."

57. This section was considered by the Court of Appeal in *Paragon Finance plc v D B Thakerar & Co* [1999] 1 All ER 400. In that case, Millett LJ distinguished two different situations in which the expressions "constructive trust" and "constructive trustee" have been used by equity lawyers (at 408-409):

> "The first covers those cases already mentioned, where the defendant, though not expressly appointed as trustee, has assumed the duties of a trustee by a lawful transaction which was independent of and preceded the breach of trust and is not impeached by the plaintiff. The second covers those cases where the trust obligation arises as a direct consequence of the unlawful transaction which is impeached by the plaintiff."

Millett LJ expanded on the distinction as follows (at 409):

> "A constructive trust arises by operation of law whenever the circumstances are such that it would be unconscionable for the owner of property (usually but not necessarily the legal estate) to assert his own beneficial interest in the property and deny the beneficial interest of another. In the first class of case, however, the constructive trustee really is a trustee. He does not receive the trust property in his own right but by a transaction by which both parties intend to create a trust from the outset and which is not impugned by the plaintiff. His possession of the property is coloured from the first by the trust and confidence by means of which he obtained it, and his subsequent appropriation of the property to his own use is a breach of that trust …. In these cases the plaintiff does not impugn the transaction by which the defendant obtained control of the property. He alleges that the circumstances in which the defendant obtained control make it unconscionable for him thereafter to assert a beneficial interest in the property.
>
> The second class of case is different. It arises when the defendant is implicated in a fraud. Equity has always given

> relief against fraud by making any person sufficiently implicated in the fraud accountable in equity. In such a case he is traditionally though I think unfortunately described as a constructive trustee and said to be 'liable to account as constructive trustee'. Such a person is not in fact a trustee at all, even though he may be liable to account as if he were. He never assumes the position of a trustee, and if he receives the trust property at all it is adversely to the plaintiff by an unlawful transaction which is impugned by the plaintiff. In such a case the expressions 'constructive trust' and 'constructive trustee' are misleading, for there is no trust and usually no possibility of a proprietary remedy; they are 'nothing more than a formula for equitable relief': *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 2 All ER 1073 at 1097, [1968] 1 WLR 1555 at 1582 per Ungoed-Thomas J."

While "the first kind of constructive trust was a creature of equity's exclusive jurisdiction," Millett LJ said, "the second arose in the exercise of the concurrent jurisdiction" (see page 410).

58. Millett LJ went on to indicate (without deciding) that section 21 of the Limitation Act 1980 does not extend to constructive trusts within the second class. He said, for example, the following (at 409-410):

> "There is no logical basis for distinguishing between an action for damages for fraud at common law and the corresponding claim in equity for 'an account as constructive trustee' founded on the same fraud. Section 21 of the 1980 Act can sensibly be limited to wrongs cognisable by equity in the exercise of its exclusive jurisdiction. It makes no sense to extend it to the exercise of its concurrent jurisdiction"

and:

> "There is a case for treating fraudulent breach of trust differently from other frauds, but only if what is involved really is a breach of trust. There is no case for distinguishing between an action for damages for fraud at common law and its counterpart in equity based on the same facts merely because equity employs the formula of constructive trust to justify the exercise of the equitable jurisdiction."

59. In *Gwembe Valley Development Co Ltd v Koshy (No 3)* [2003] EWCA Civ 1048, [2004] 1 BCLC 131, the Court of Appeal concluded that the trust at issue in that case was "a class 2 trust, within Millett LJ's classification" (paragraph 119), with the result that the claim could not be brought within section 21(1)(b) of the Limitation Act 1980 but (in the words of the judgment) "stands or falls on s 21(1)(a)" (paragraph 120). On the face of it, the Court of Appeal was therefore proceeding on the basis that section 21(1)(a) could apply in the case of a class 2 constructive trust. However, in *Halton International Inc v Guernroy Ltd* [2006] EWCA Civ 801 Carnwath LJ observed:

> "I should note that, although the judgment in *Gwembe* (to which I was a party) proceeded on the premise that fraud was sufficient to bring the case within s 21(1)(a) (para 120), the ultimate decision may be better explained by reference to the alternative ground of fraudulent concealment: s 32."

Carnwath LJ then explained that section 21:

> "is about deemed possession: the fiction that the possession of a property by a trustee is treated from the outset as that of the beneficiary. In the words of Millett LJ, the possession of the trustee is 'taken from the first for and on behalf of the beneficiaries' and is 'consequently treated as the possession of the beneficiaries'. An action by the beneficiary to recover that property is not time-barred, because in legal theory it has been in his possession throughout."

60. In *J D Wetherspoon plc v Van de Berg & Co* [2007] EWHC 1044 (Ch), [2007] PNLR 28, Lewison J commented (at paragraph 36) that the *Gwembe* case was binding on him. Having regard, however, to Millett LJ's reasoning in *Paragon* and Carnwath LJ's comments in *Halton*, it seems to me that a higher Court would be very likely to hold that section 21(1)(a) of the Limitation Act 1980, like section 21(1)(b), does not apply to class 2 constructive trusts. That suggests that, for the derivative claim ultimately to succeed on the strength of section 21(1)(a), Mr Kleanthous would need to establish that there was a class 1 constructive trust.

61. Arguing that this is a class 1 case, Mr Keen said that the reality is that Mr Paphitis took the assets of RGL and improperly used them to purchase La Senza in the name of his own shell company. On the other hand, Mr Kitchener and Mr Snowden each argued that any claim would be within Millett LJ's class 2. Mr Snowden, for example, submitted that neither the shares in Xunely nor any remuneration received by any of the Director Defendants could represent pre-existing property of RGL to which fiduciary obligations attached. As regards the allegation that funds of the Ryman Companies were improperly lent to Xunely, Mr Snowden pointed out that the loans were repaid within a couple of years and said that the Xunely shares in respect of which an account is claimed could not be said to be either an accretion to, of graft upon, the loans.

62. Assuming, however, that (contrary to Mr Kitchener's and Mr Snowden's submissions) this is a class 1 case, Mr Kleanthous would still have to prove in respect of each of the Director Defendants that there had been fraud (because section 21(1)(a) of the 1980 Act is applicable only to claims in respect of "any fraud or fraudulent breach of trust"). Having regard to matters such as those mentioned in paragraph 54 above, establishing fraud would not be easy.

63. Turning to section 32 of the Limitation Act 1980, this is in the following terms:

> "(1) … where in the case of any action for which a period of limitation is prescribed by this Act, either—
>
> (a) the action is based upon the fraud of the defendant; or

> (b) any fact relevant to the plaintiff's right of action has been deliberately concealed from him by the defendant; or
>
> (c) the action is for relief from the consequences of a mistake;
>
> the period of limitation shall not begin to run until the plaintiff has discovered the fraud, concealment or mistake (as the case may be) or could with reasonable diligence have discovered it.
>
> References in this subsection to the defendant include references to the defendant's agent and to any person through whom the defendant claims and his agent.
>
> (2) For the purposes of subsection (1) above, deliberate commission of a breach of duty in circumstances in which it is unlikely to be discovered for some time amounts to deliberate concealment of the facts involved in that breach of duty."

64. Mr Kleanthous alleges that the letter Mr Paphitis sent him on 17 August 1998 (see paragraph 20 above) involved deliberate concealment. The Particulars of Claim say the following about this:

> "Paphitis' statement in the said letter that '[La Senza] *was not purchased by Chancerealm Ltd and it was not a Chancerealm deal'* amounted to deliberate concealment by Paphitis (on his own behalf and on behalf of Cooke, Towner and Childs) of the wrongful misuse of RGL (and/or Ryman) funds and the diversion of the La Senza Opportunity and misuse of assets."

65. By the close of argument, Mr Keen was no longer pursuing the suggestion that the correspondence showed there to have been deliberate concealment on the part of Mr Cooke, Mr Towner or Mr Childs; he limited the allegation of concealment to Mr Paphitis. It seems to me, however, that Mr Kleanthous' prospects of showing that the letter involved deliberate concealment even on the part of Mr Paphitis are quite poor.

66. Other factors make it even harder for Mr Kleanthous to rely on section 32 of the 1980 Act. Arguably, the companies whose claims are at issue (viz. RGL and RL) can be said to have known all the relevant facts (through Mr Childs, if not otherwise). Mr Kleanthous himself was evidently aware of the fact that a company associated with Mr Paphitis had purchased La Senza, and it can be plausibly argued that Mr Kleanthous could with reasonable diligence have discovered any other facts relevant to the causes of action. It is relevant in this context that "the statutory words 'any fact relevant to a plaintiff's right of action' are to be given a narrow rather than a wide interpretation" (*The Kriti Palm* [2006] EWCA Civ 1601, [2007] 2 CLC 223, at paragraph 322). As was explained in *The Kriti Palm* (in paragraph 322), in *Johnson v Chief Constable of Surrey* (unreported, 19 October 1992), the Court of Appeal accepted a "submission that 'the relevant fact must be a fact without which the cause of action is incomplete', contrasting a fact relevant to an action and to a *right* of action". It is relevant too that the question is not whether matters *should* have been discovered sooner but whether they *could* have been with reasonable diligence (see the *Paragon* case, at 418). In *Paragon*, the Court of Appeal said (at 418) that "the test

was how a person carrying on a business of the relevant kind would act if he had adequate but not unlimited staff and resources and were motivated by a reasonable but not excessive sense of urgency". Mr Kitchener submitted that, in the present case, the published accounts would have been sufficient to put Mr Kleanthous on the scent, especially as he had the assistance of an accountant.

67. My overall conclusion is that there are arguable claims against the Director Defendants, but the chances of the claims succeeding are significantly less than evens. The claim against Mr Childs strikes me as particularly weak.

68. With regard to the quantum of the claims, a very large sum could potentially be recovered from Mr Paphitis if an account of profits were ordered. It is much less clear that the Ryman Companies would stand to recover very large amounts from Mr Cooke and Mr Towner. On the face of it, Mr Childs has not received any profits for which he could be liable to account.

Factors relevant to whether permission should be given

69. I shall consider in turn below such of the matters listed in section 263 of the Companies Act 2006 as seem to me to be of particular significance in the present case.

Section 263(2)(a) (whether a person acting in accordance with section 172 would not seek to continue the claim)

70. As mentioned above (paragraph 38), section 263(2)(a) is applicable only where *no* director acting in accordance with section 172 of the 2006 Act would seek to continue the claim. I am not satisfied that that is the case as regards Mr Paphitis or even Mr Cooke or Mr Towner. In contrast, I have been persuaded by Mr Snowden and Mr Michael Todd QC, who appears with Miss Mary Stokes for the Ryman Companies, that section 263(2)(a) is in point as regards Mr Childs. He is in a somewhat different position to Mr Cooke and Mr Towner since he never had any interest or role in Xunely. As I have already said, the claim against him seems particularly weak, and he does not appear to have received any profits for which he could be liable to account. In the circumstances, I consider that "a person acting in accordance with section 172 … would not seek to continue the claim" so far as Mr Childs is concerned. It follows that I am required by section 262(2) to refuse permission to continue the claim as against Mr Childs.

Section 263(3)(b) (the importance that a person acting in accordance with section 172 would attach to continuing the claim)

71. In *Wishart v Castlecroft Securities Ltd*, Lord Reed said (at paragraph 37):

> "A hypothetical director acting in accordance with section 172, and considering whether to commence legal proceedings, could ordinarily be expected to have regard to a range of factors, including the amount at stake, the apparent strength of the case, the prospects of securing a satisfactory outcome without litigation, the prospects of successful execution of any judgment, the likely cost of the proceedings, the disruption

> caused to the company's business, and potential risks to reputation and business relationships."

72. I have commented above on the size and strength of the claim, and I am not aware of any reason to think that a judgment would go unsatisfied. As regards costs, these could doubtless be very substantial, but the Ryman Companies would probably be in a position to bear them. So far as disruption to business, reputation and relationships is concerned, Mr Kyprianou has advanced a number of reasons for considering that the claim would be very damaging to the Ryman Companies. Mr Kyprianou summarised the views of himself and Mr Lakin in these terms in a witness statement:

> "To sum up, Simon [Lakin] and I find it very difficult to contemplate a situation in which the Companies bring a fraud claim (or continue the Derivative Claim) against their major shareholders and the other Defendant Directors. However, we believe it would have a devastating effect on the Ryman business for the following reasons:
>
> (a) the Companies are likely to lose four of their most experienced directors. This in turn is likely to damage the trading performance of the RGL Group, staff morale and the reputation of the Companies;
>
> (b) replacing the Defendant Directors with candidates of similar skills and experience would be extremely difficult and, in the case of Theo Paphitis, impossible;
>
> (c) damaging the reputation of Theo Paphitis would mean damaging the reputation of Ryman, as Theo Paphitis' name is very closely linked to the Ryman brand. The RGL Group would no longer benefit from the considerable free publicity gained by its association with Theo Paphitis and the numerous business advantages that result from this association;
>
> (d) the impact on employees, customers, suppliers and other shareholders would be disastrous and would be likely to cause a significant deterioration in the RGL Group's performance and consequently its value; and
>
> (e) the litigation would provide a significant distraction to any remaining senior management."

73. Mr Keen understandably sought to minimise the significance of Mr Kyprianou's evidence, but to my mind there is much force in what Mr Kyprianou says.

Section 263(3)(e) (whether the company has decided not to pursue the claim)

74. As explained above (paragraph 31), RGL and RL each set up a committee comprising Mr Kyprianou and Mr Lakin to seek professional advice and make decisions in relation to these proceedings. The committees decided against bringing or continuing the claim.

75. Mr Keen argued that Mr Kyprianou and Mr Lakin are "anything but independent". While, however, Mr Kyprianou has been a director of a number of companies associated with Mr Paphitis, he and Mr Lakin received legal advice on their duties (including that they should not allow the effect of any decision on themselves or other directors to influence them) and had no involvement with Xunely's original acquisition of La Senza. Mr Keen drew my attention to the comment in Boyle, "Minority shareholders' remedies", at page 80, that it is "important that allegations of seriously abusive behaviour should not be defeated by assertions of genuine belief by board members or shareholders who think that litigation must always be the worst option; either financially or in terms of corporate reputation". On the facts of the present case, however, I do not think I would be justified in ignoring the conclusions arrived at by the chief executive officer (Mr Kyprianou) and finance director (Mr Lakin) of the relevant companies. To the contrary, I accept Mr Todd's submission that I should attach considerable weight to those conclusions. Mr Kyprianou and Mr Lakin are better placed than I am to assess where the companies' commercial interests lie.

Section 263(3)(f) (whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than on behalf of the company)

76. The Defendants all argue that Mr Kleanthous could pursue his complaints more appropriately by a petition pursuant to section 994 of the 2006 Act (unfair prejudice).

77. Mr Kyprianou said this on the subject in his witness statement:

> "If the Companies were to bring a claim against the Defendant Directors they would be bringing a claim against the majority shareholders, namely Theo Paphitis and Ian Childs, who together own around 85 per cent. of the shares in RGL. Even assuming, for present purposes, that the sums which the Companies could recover are as large as those asserted by Tony Kleanthous, the Companies have no immediate requirement for such very large sums. This means that, after paying legal costs, the majority of any sums recovered by the Companies from the Defendant Directors would be likely to be returned to shareholders. Therefore 85 per cent. of any sums recovered, after the payment of costs, would be returned to two of the Defendant Directors. We do not consider this a rational way of proceeding when we are advised that Tony Kleanthous could bring proceedings by way of an unfair prejudice petition to obtain a remedy from the Defendant Directors for wrongs which he contends he has suffered at their hands without involving the Companies other than as nominal defendants."

78. In *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch), [2009] 1 BCLC 1, Mr William Trower QC, sitting as a Deputy High Court Judge, gave considerable weight to the fact that the Claimant should be able to achieve all that it could properly want through a section 994 petition and shareholders' action which were already on foot (see paragraphs 53 and 54). In *Iesini v Westrip Holdings Ltd*, Lewison J said (in paragraph 126) that the availability of an alternative remedy under section 994 was one of the factors which would have led him to the conclusion that, had he not

adjourned the matter, it would not have been appropriate to allow a derivative claim to proceed.

79. In contrast, the availability of an alternative remedy under section 994 did not appear to the Inner House to be a compelling consideration on the facts of *Wishart v Castlecroft Securities Ltd*, where Lord Reed commented (in paragraph 46) that such proceedings would "constitute, at best, an indirect means of achieving what could be achieved directly by derivative proceedings". Similarly, in *Stainer v Lee* Roth J considered a derivative action "entirely appropriate" and "the theoretical availability to the applicant of proceedings by way of an unfair prejudice petition … not a reason to refuse permission"; the applicant was "not seeking to be bought out" (paragraph 52).

80. In the present case, likewise, it was submitted on Mr Kleanthous' behalf that he was not seeking a buy-out of his shares. However, the evidence indicates that Mr Kleanthous is interested in being bought out. Mr Kleanthous himself referred in a witness statement to having said to Mr Paphitis in 2008 that he "hoped [Mr Paphitis] would agree to buy [his] RGL shares at a fair price so that [they] could both move on with [their] separate lives". In a more recent witness statement, Mr Kleanthous said that he had "made no secret about the fact that [he] would be willing to sell [his] shares in RGL at a fair price". Further, there has been reference to a petition being presented under section 994. In a letter dated 2 June 2010, Mr Kleanthous' solicitors said that they had been "instructed to prepare, in addition to the derivative proceedings, an application under Section 994 of the Companies Act 2006". One is left with the suspicion that Mr Kleanthous has chosen to pursue derivative proceedings alone in the hope that that he will be able to obtain a costs indemnity (with the result that the other shareholders in RGL would be likely to bear the bulk of the costs even if the claims against them failed).

81. In all the circumstances, I agree with Mr Todd that the availability of an alternative remedy in the form of an unfair prejudice petition is a powerful reason to refuse permission for the derivative claim to proceed in this case.

Section 263(4) (views of members with no personal interest in the matter)

82. Section 263(4) of the 2006 Act directs the Court to have "particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter". Mr Snowden referred in this connection to evidence given by Mr Childs. Mr Childs expressed the following, among other, views in a witness statement:

> "… I do not think that it would be in the best commercial interests of RGL (or of me as a minority shareholder) for Mr Kleanthous to be given permission to bring the claims which he seeks to bring on behalf of RGL. RGL bringing proceedings against the majority of its own board will be damaging to the Ryman brand as well as disruptive and very costly …. If Mr Kleanthous wishes to pursue his allegations, he has the ability to do so as a minority shareholder in his own right, and can seek a buy-out order for his shares, which is plainly what he really wants."

83. Since Mr Childs is one of the proposed Defendants, I doubt whether he is strictly to be regarded as a member with "no personal interest, direct or indirect, in the matter". His views still seem to me to be of relevance, especially since (a) he has a shareholding in RGL which is not very much smaller than Mr Kelanthous' and (b) he does not appear to have benefited in any way from Xunely's acquisition of La Senza.

Conclusion

84. In the end, I did not understand Mr Keen to press me to grant permission for the claim to be continued as against anyone but Mr Paphitis. Mr Keen submitted in his reply that I could most properly grant permission against Mr Paphitis alone on the basis that (a) concealment may not have been pleaded against the other Director Defendants and (b) the quantification of any claim is more problematic against Director Defendants other than Mr Paphitis.

85. I have concluded, however, that I should not grant permission for the claim to be continued at all. I have already expressed the view that section 263(2)(a) applies in relation to Mr Childs (with the consequence that permission has to be refused as against him). With regard to the other Director Defendants, I do not consider the claim Mr Kleanthous wishes to pursue to be of such strength and size (even in the case of Mr Paphitis) as could make it appropriate for me to grant permission when (a) that course is strongly opposed, on a reasoned basis, by the Ryman Companies' independent committees as well as by Mr Childs, (b) it is open to Mr Kleanthous to seek redress by means of an application under section 994 of the 2006 Act and (c) much of any money recovered from the Director Defendants could be expected to be returned to them by way of distribution. In fact, factors (a), (b) and (c) would have caused me to hesitate to grant permission even if I had been persuaded that the proposed claim was a strong one.

Other matters

86. Amongst the matters on which I heard argument were (a) whether there is jurisdiction to authorise a "double derivative" action (i.e. one in which a member of a company brings a claim on behalf of a subsidiary of the company), (b) whether the proposed claim would have been allowed to proceed at common law (as required on the facts of this case by paragraph 20(3) of schedule 3 to the Companies Act 2006 (Commencement No. 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007) and (c) whether it would have been appropriate to grant Mr Kleanthous a costs indemnity. Given the conclusions I have already arrived at, I do not think I need explore these questions.

Outcome

87. In all the circumstances, I shall refuse permission to continue the claim and dismiss Mr Kleanthous' application. I shall further adjourn all consequential matters (including any application for permission to appeal) to a date next term.

Neutral Citation Number: [2019] EWHC 3183 (Ch)

Case No: BL-2019-MAN-000051

IN THE HIGH COURT OF JUSTICE
BUSINESS & PROPERTY COURTS IN MANCHESTER
INSOLVENCY AND COMPANIES LIST (Ch D)

Manchester Civil Justice Centre,
1 Bridge Street West, Manchester M60 9DJ

Date: 22 November 2019

Before:

HIS HONOUR JUDGE STEPHEN DAVIES
SITTING AS A JUDGE OF THE HIGH COURT

- -

Between:

(1) ROBERT GLEW & DENTON AND CO TRUSTEES LIMITED
(2) NICHOLAS HENDERSON & DENTON AND CO TRUSTEES LIMITED — **Claimants**

- and -

(1) DR ARPI MATOSSIAN-ROGERS
(2) YVONNE PAMBAKIAN
(3) AMRO BIOTECH PLC — **Defendants**

- -
- -

Mark Harper QC (instructed by **Harrison Drury Solicitors, Preston**) for the **Claimants**

Paul Strelitz (instructed by **Venner Shipley Solicitors, London EC1A**) for the **First and Second Defendants**

Hearing dates: 28 – 29 October 2019
Draft judgment circulated: 6 November 2019

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APPROVED JUDGMENT

I direct that pursuant to CPR PD 39A paragraph 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

……………………………………..

His Honour Judge Stephen Davies

His Honour Judge Stephen Davies:

Introduction and summary of decision

1. The claimants seek permission under s.261 Companies Act 2006 [“**CA 2006**”] to continue the claim issued on 28 May 2019 as a derivative claim. In summary, the claimants, being two of the minority shareholders in the third defendant company, Amro Biotech plc [“**the Company**”], seek permission for the Company to bring a claim against the first defendant [“**Dr Rogers**”] and the second defendant [“**Ms Pambakian**”] alleging breach by them of their duties as directors towards the Company. The first and second defendants are, directly and indirectly through family shareholdings, the owners of 81.4% of the shares in the Company. The Company has, of course, taken no active part in the application for permission. Thus, although the Company is a nominal defendant to the claim form, for convenience I shall refer to Dr Rogers and Ms Pambakian as the defendants.

2. Both the claimants and the defendants have filed voluminous evidence and I have read and heard detailed and impressive submissions from their respective counsel Mr Harper QC and Mr Strelitz over the course of a two-day hearing. Having considered the evidence and the submissions I have come to the conclusion that permission should not be granted. After circulation of my judgment in draft Mr Harper invited me to consider amplifying or clarifying certain parts of the judgment and I confirm that to the extent I consider it necessary or otherwise appropriate I have done so. Some of his invitations appeared to me clearly to fall on the wrong side of the line between legitimate requests for amplification or clarification and attempts to re-argue the case.

3. I set out my reasons below under the following sub-headings:

Section	Subject	Paragraphs
A	Relevant facts	4 - 40
B	Relevant legal principles	41 - 51
C	Evaluation of the strength, size and importance of the claims	52 - 84
D	Consideration of the relevant factors	85 - 100
E	Conclusions	101 - 109

A. Relevant facts

4. I cannot on an application such as this resolve disputed factual issues where all of the relevant evidence may not be before me and where oral evidence may be required. Nonetheless, in order to determine this application fairly and in accordance with the relevant principles it has been necessary for me to consider the documentary evidence produced in some detail and with some care in order that I can make a proper assessment of the strength of the proposed claims before deciding whether or not permission should be given for the claim to be continued as a derivative claim.

5. Dr Rogers is an academic scientist who has had a career as a lecturer and researcher at the Royal London Hospital. She has also had a lifelong interest in and had undertaken discovery research into the causes and treatment of diabetes. In the course of that research she identified certain monoclonal antibodies as having the potential to be used in the treatment of diabetes and in the prediction of the onset of diabetes. In 1997 she filed for and duly obtained a patent in the UK (and later internationally) in relation to discoveries she had made in that area ["**the 1997 patent**"]. By 1999 she had resigned as lecturer, her intention being to work with her late husband and her daughter, Ms Pambakian, to proceed from discovery research into development research with a view to producing a medicine using monocolonal antibodies to treat diabetes.

6. It was clear that finance would be required in order to fund research and development ["**R&D**"], including clinical trials and obtaining regulatory approval, before products could be developed, approved and placed on the market. The Company was incorporated for this purpose in May 1999 as a result of advice from a Mr Watkins (an accountant, who became finance director of the Company and who remains a shareholder and now supports this claim) and to Mr Walker (another accountant, then with a firm known as Mazars, who became commercial director of the Company and who also remains a shareholder and supports this claim). The strategy was for the Company to secure investment funding and then undertake the necessary R&D and obtain the necessary approvals leading to production and marketing. For these purposes it was decided that the Company would be granted a licence by Dr Rogers to use the 1997 patent. It was agreed that the Rogers family would obtain at least 75% of the controlling shareholding in the Company. Whilst the witness statements of Dr Rogers on the one hand and Mr Watkins and Mr Walker on the other reveal disputes as to what was agreed between them at the time of incorporation of the Company, I am not in any position to draw any clear conclusions one way or another and nor are such matters decisive of the current application.

7. What is common ground is that in July 1999 two relevant agreements, drafted by reputable solicitors, were entered into between Dr Rogers and the Company. The first was a Patent Licence Agreement ["**the 1999 PLA**"] and the second was a Service Agreement ["**the SA**"]. The provisions of these agreements in relation to the ownership of what was defined as "Improvements" to the defined "Patent Rights" (defined as being the 1997 patent) and "Know-How" (defined as being the know-how relating to the 1997 patent) are of critical importance to this case.

8. In summary, under the 1999 PLA Dr Rogers granted the Company the right to use the patent rights and the know-how for a minimum term of 15 years, rolling on from year to year unless subsequently terminated on notice[1], for the purposes of carrying out R&D to obtain authorisation to market and sell the "Products" (defined as "diagnostic, predictive and medicinal products for diabetes and any other applications discovered during the carrying out

[1] The Company had the right to terminate within the 15 year term on 6 months' notice, but Dr Rogers had no such right.

of R&D or otherwise during the term of the licence") in return for the payment of 4% royalty on the "Net Sales Value" (as defined) of such products.

9. Of considerable significance to this case are the provisions made for improvements, widely defined as being "all improvements, modifications or adaptions to any part of the inventions the subject of the patent rights and the know-how which might reasonably be of commercial interest to either party in the development, manufacture or supply of the products which may be made or acquired by either Dr Rogers or the Company during the term of the agreement". For convenience and save where necessary to distinguish I shall refer to this compendiously as improvements to the Intellectual Property ["**IP**"]. Under clause 10, as material and in summary: (a) there was a mutual obligation to disclose improvements to each other; (b) the Company was entitled to use and exploit improvements disclosed by Dr Rogers during the course of the agreement; (c) improvements arising from work carried out by Dr Rogers alone should remain her exclusive property, whereas improvements arising from work carried out by the Company alone should remain its exclusive property and each party should have the exclusive right to apply for patent protection in that respect; (d) the Company's improvements included those arising from work carried out by Dr Rogers for the Company under the 1999 PLA; (e) improvements arising from work carried out jointly should belong to the parties equally and they should each have the right to use such information independently of each other.

10. Although there was no definition of what was meant by "work carried out", there was a consultancy provision in clause 12 of the 1999 PLA under which Dr Rogers agreed to provide consultancy services in return for remuneration as payable under the SA, which included assisting in the ongoing operation and development of the know-how. She also agreed to assign to the Company all rights she might have in respect of the product of the consultancy services, including the right to apply for patent or other IP rights protection.

11. Under the SA the Company appointed Dr Rogers as chairman and joint CEO at an annual salary of £50,000 plus a bonus provision on the basis of her devoting substantially her whole time, attention and ability to her duties. Under clause 11, entitled "inventions", it was provided, as material and in summary, that in relation to IP: (1) it was foreseen that Dr Rogers might generate IP in the course of her duties; (2) it was agreed that she had a duty to further the Company's interests in that respect; (3) she was required to disclose any such IP "relating to or capable of being used in the" Company's business to the Company on the basis that it was to be its absolute property to exploit. It was also provided that if "during the appointment" she should generate IP which was not to be the Company's property then the Company nonetheless had the right to acquire the IP within 6 months of her disclosing the same, on terms to be agreed or in default settled by arbitration.

12. It was provided that the SA would continue subject to termination on 12 months' notice but last for at least 3 years, save that it would terminate automatically on Dr Rogers' 70th birthday in June 2013.

13. At around the same time as the 1999 PLA and SA were entered into the Company issued a prospectus seeking investment of up to £1.5 million. It was explained that in order to develop the product it would be necessary to obtain funding to proceed to phase 1 and then to phase 2 clinical trials. It was stated that Dr Rogers would be mainly responsible for R&D and overseeing patent related matters, including the design and management of the clinical trials which were to be carried out by separate subcontracted companies. Reference was made to the potential availability of Enterprise Investment Scheme ["**EIS**"] tax relief for investors. It was envisaged that if the phase 1 and 2 clinical trials went well it would still be necessary to proceed to phase 3 trials before a product licence application could be made. The Appendix made reference to, and summarised, some of the provisions of the 1999 PLA and the SA.

14. It appears that some £300,000 was raised, which was enough to fund clinical trials, and that in 2005 further substantial investment was sought from a Swiss-based investment company, which was duly provided and channelled through a Dutch registered company known as Amro Biotech (Netherlands) BV ["**Amro BV**"]. It was proposed that Amro BV be granted a sub-licence to exploit the IP. In connection with this proposal a side letter amending the 1999 PLA was entered into, the drafting of which is said by the claimants to have materially impacted on the amount of the royalties payable under the 1999 PLA. In 2006 a report into the valuation of the product under development was commissioned by Amro BV, which recorded that the phase 1 and 2 clinical trials had been undertaken (by a company associated with the Company, known as NDR Ltd) and that the development was close to starting phase 3 trials in the Netherlands. It suggested that the product, if successfully approved, had a value of $9.5 billion. This valuation was heavily caveated and has subsequently been criticised by the claimants; nonetheless it does indicate that at the time the perception was that if the product could be developed and successfully brought to market it would have a very substantial value.

15. At around the same time, a further application for a further patent was made in the UK (in August 2005) and subsequently internationally and duly granted ["**the 2005 patent**"]. It described Dr Rogers as the inventor. The subject matter of the 2005 patent was stated to be certain peptides derived from certain antibodies, and it was further stated that this was a concept originally described in the 1997 patent. Reference was made to diabetes and to other diseases which might be suitable for treatment using this invention. In her first witness statement Dr Rogers asserts that the 2005 patent resulted from work carried out in her own time and alone apart from her work for the Company. She explains the nature of the invention at paragraph 38 of her first witness statement and in paragraph 39 states her understanding that the 1999 PLA and the SA covered only the drug development work to get through the regulatory pathways to bring the product to market, which is different from the "innovative intellectual work that led to improvements which I did as licensor, alone in my own time". She does not, however, provide details as to the circumstances in which this "innovative intellectual work" was done and how it differed from the work which she did in her capacity as paid consultant to the Company working under the SA. Ms Pambakian's evidence is even less detailed, simply referring to Dr Rogers having worked at nights and at weekends throughout her working life when engaged in research and writing.

16. In his second witness statement, produced in response to the evidence lodged by the defendants, Mr Glew asserts at paragraph 22 that the 2005 patent adopted the clinical trials which were undertaken and paid for by the Company and at paragraph 23 that a subsequent 2014 patent, also applied for and obtained in Dr Rogers' name, relied on evidence obtained from clinical trials also paid for by the Company. However that evidence is not, of course, evidence from someone with expert knowledge in the area in question and, it might be said, involves an assumption that an invention which arises out of material obtained from a clinical trial paid for by an entity must therefore also belong to that entity, regardless of the degree of connection between the material and the ultimate invention.

17. In her letter to shareholders of May 2008 Dr Rogers, writing in her capacity as chairman of the Company, referred to the ongoing clinical programme and its expansion to cover other conditions such as cancer. She referred to the agenda to move the company forward as including "new product development, new indications [i.e. conditions], new IP submissions". She did not expressly refer to the 2005 patent as having been applied for and obtained in her name, but neither did she suggest that it belonged to the Company. The annual report and accounts for the year ended 30 June 2008 did not specifically address these issues either. Mr Walker does not in his witness statement explain whether or not he was aware that the 2005 patent had been filed for in Dr Rogers's name or, if he was, whether he considered that this represented a breach of the 1999 PLA or was otherwise concerned about this development.

18. Although it appears that substantial further R&D was undertaken with the benefit of the monies invested through Amro BV unfortunately the project was subsequently delayed for a number of years for a number of reasons, one of which was the adverse publicity resulting from the tragic death of Dr Rogers' other daughter, resulting from the administration of an experimental drug by Ms Pambakian, and the subsequent investigations into the circumstances in which that drug had been administered, concluding in regulatory proceedings being brought by the General Medical Council against Ms Pambakian which resulted in her being struck off the register as a doctor. By 2014 Dr Rogers was reporting to shareholders that the intention was to secure further funding of £2.5 million in order to commission large clinical trials which it was hoped would lead to a licensing deal with a pharmaceutical company which it was hoped might result in an initial payment of £1 billion as well as the payment of further milestone and royalty payments.

19. In June 2013 Dr Rogers turned 70, with the result that the SA automatically terminated. This is potentially relevant since the claimants seek to rely on the provisions of SA in certain respects, whereas the defendants submit that there can be no basis for reliance on its after June 2013. Mr Harper submitted that there was no reason why the SA could not have impliedly been renewed on a consensual basis thereafter, terminable by reasonable notice, in circumstances where Dr Rogers continued to perform her role as chairman. Mr Strelitz riposted that any such continuance would be inconsistent with the fact, as is apparent from the accounts, that Dr Rogers did not draw any remuneration from the Company in the year ending June 2013 or subsequently. Insofar as it matters, and I do not think that it is decisive, resolution of this issue

would depend on further evidence and I cannot at this stage reach any clear view as to how it would be likely to be decided at any trial.

20. In early 2015 Mr Walker resigned, leaving Dr Rogers and Ms Pambakian as the only two remaining directors. At the same time there was a proposal to undertake clinical trials in Brazil. It was apparent from the report and accounts for year end 30 June 2015 that without further funding the planned trials could not proceed.

21. In late 2015 the claimants first became involved with the Company. It was intended that they should provide business advice and assistance in relation to obtaining investment funding. They had a background in finance and they had private equity fundraising experience. They entered into confidentiality agreements and, subsequently, a consultancy agreement with the Company. The latter made clear that their role was to seek out and secure funding for up to £5 million for the testing and marketing of "a drug developed by and registered to the Company, under licence, for the treatment of diabetes and other diseases". The claimants accept (see paragraph 37 of their letter before action) that Dr Rogers informed them at this stage that she was the beneficial owner of all patents.

22. At the same time the claimants each acquired a relatively modest shareholding in the Company. There are issues as to whether or not it was agreed that they should also become directors of the Company and, if so, at whose instigation and for what purpose(s). There are also issues as to whether or not they ought to have received further shares under the consultancy agreement. However, these issues are not ones which I can, or need to, resolve for the purposes of this application.

23. In an email dated 11 August 2016 Mr Glew suggested that input from solicitors and from valuers be obtained as regards a proposed new licence agreement. It is clear that the claimants believed that the current situation, where the 1999 PLA was being held over from year to year, was not a satisfactory vehicle for obtaining long term investment funding and that a new long term licence agreement was required in order to do so. It was perceived to be necessary to demonstrate for investment and tax purposes that the licence agreement was in appropriate terms, both legally - and in particular as regards the right to exploit the IP, and from a valuation perspective to justify the royalty to be paid to Dr Rogers. In his email Mr Glew referred to the importance of establishing that the IP rights had been "properly and fully granted to the Company" in order to satisfy potential investors.

24. A valuation was obtained dated 24 October 2016, which confirmed that the royalty rate of 4.5% proposed was a reasonable one, and which appeared to satisfy Mr Glew.

25. Dr Rogers was reluctant for the solicitors recommended by Mr Glew to produce a draft licence agreement and, instead, she produced one herself. Although it was based substantially on the 1999 PLA there were some key differences. In particular, and as relevant to this case, clause 10 relating to improvements was significantly different, because it provided that: (a) Dr Rogers should have the exclusive right to patent any improvements made by the Company, albeit that

the Company should be entitled to use such improvements for the duration of the agreement; (b) Dr Rogers should own all improvements and know-how, regardless of whether the improvements arose from work carried out by Dr Rogers, the Company or jointly, and even where such improvements arose during the consultancy services which Dr Rogers agreed to provide to the Company.

26. What is rather odd is that neither of the claimants appear to have raised – at least in writing - any concern at the time that these terms did not provide the comfort which they or other investors required. This is notwithstanding that it is apparent from the email written by Mr Glew in August 2016 that he was aware of these clauses. The claimants rather skated over this point in their letter of claim at paragraphs 43 – 47 and in my view paragraph 48 gives a positively wrong and misleading impression in making no reference at all to the contemporaneous knowledge of the claimants as to the offending clauses or their involvement in the circumstances in which the 2016 PLA came to be produced and entered into.

27. There is a dispute as to the role of the solicitors. It is unclear to me at least from the evidence on what basis and by whom they were instructed and what they did. Whilst there is no evidence that they were instructed either by the claimants or by the Company to provide independent legal advice as to the ownership of the IP or as to whether or not the draft PLA properly reflected the interests and requirements of the Company going forwards, nonetheless it is plain that the solicitors had sight of the draft PLA and made a number of amendments to the draft without including any amendments to the provisions of the draft as regards the ownership of the IP going forwards so as to bring them into line with the terms of the 1999 PLA.

28. In November 2016 there was a meeting, attended by Dr Rogers, the claimants and the solicitors they had involved, at which the draft was discussed. The claimants do not suggest that they challenged the terms referred to above. They have said repeatedly that they relied upon representations made by Dr Rogers that she was the rightful owner of the patents. However this does not in my view adequately answer a point of some importance, which is that at the time the claimants either did not believe that the terms of the draft PLA were fatal to the commercial success of the venture in terms of securing new investment or, if that is what they believed, there is no record of their saying so.

29. The end result was that an agreement [“**the 2016 PLA**”] was entered into on 6 December 2016 in substantially the same terms as the draft produced by Dr Rogers. It was signed by Dr Rogers on her own behalf and by Ms Pambakian for the Company, who had been authorised to sign it pursuant to a board meeting attended by Dr Rogers and Ms Pambakian. The patent rights referred to comprised the 2005 patent together with the further patent filed in 2014 [“**the 2014 patent**”] which was described by Dr Rogers in a letter to a shareholder dated 21 November 2016 as being for the oral delivery of one of the Company’s products for diabetes and related conditions.

30. Mr Glew states in his second witness statement that the falling out occurred as early as 6 December 2016 and that at that meeting Dr Rogers proceeded to sign the 1999 PLA notwithstanding the claimants complaining in terms that she had failed to renew and extend the 1999 PLA as had been agreed. However, there is so far as I am aware no written record of this. The first relevant letter of complaint appears to be that dated 3 April 2017, written by the claimants to all of the shareholders listed on the register of members of the Company, setting out their "serious concerns relating to corporate governance". This was a detailed and strongly worded letter, containing significant criticism of the defendants in a number of respects. It included complaint about the Company's entry into contracts which "might be considered unfairly prejudicial to the interests of majority shareholders".

31. The defendants' case is that the impetus for this dramatic turn of events was their decision not to renew the claimants' consultancy agreement and not to go along with the claimants' suggestion that they be appointed directors of the Company. They contend that the claimants' complaints were simply a device to seek to obtain control of the management of the Company. The claimants deny this. The defendants make a number of criticisms of the claimants' conduct and, in particular, the aggressive tenor of the wide-ranging complaints made in the letter of 3 April 2017, including but not limited to the reference to the tragic circumstances of the death of Dr Rogers' daughter which, the claimants asserted in the letter, ought to have led to the defendants divesting themselves of control of the Company. I agree that the letter was aggressive in its content and tenor and that the complaint made in relation to the death of Dr Rogers' daughter was insensitive and of little if any relevance to the position in 2017.

32. One particular complaint made by the claimants in their letter was that one effect of the changes to the definition of net sales value was that Dr Rogers would be entitled to receive 4.5% of the sales achieved by sub-licensees, as opposed to 4.5% of the royalty income earned by the Company from such sales. They were also critical of the valuation obtained in 2006, describing it as "wildly unrealistic". Nonetheless, the claimants did not make specific reference in that letter to the ownership of the patents or to the changes made to the PLA as regards the ownership of improvements. It is true however that this point was raised in the claimants' subsequent letter to the defendants of 28 May 2017, written in the context of a forthcoming AGM, in which a complaint was made in terms that, contrary to the terms of the 1999 PLA, the subsequent patents had been applied for showing Dr Rogers as owner. The claimants went so far as to demand an explanation as to why that did not amount to the shareholders of the Company being "defrauded of their interest in … the Company's IP".

33. As the minutes of the 2017 AGM held on 30 May 2017 make clear the claimants ventilated their complaints at the AGM. The meeting was attended by a solicitor, a Mr Charnley of a firm known as King and Spalding. The minutes recorded that the directors intended to instruct that firm to undertake a review of the Company's IP "in the near future". The claimants are recorded as saying that they had been asking for nearly a year about the ownership of IP but had received no answers. They were asserting that the provisions of the 1999 PLA as regards the ownership of the IP had not been adhered to.

34. Further criticisms of the defendants were levied in the claimants' letter of 28 June 2017, written following the AGM. In that letter the claimants were effectively seeking to achieve the removal of the defendants from the board and their replacement by an independent board together with the defendants agreeing to address the other complaints and agreeing to reduce the family shareholding to below 75% in order, as the claimants saw it, to achieve further investment to allow the Company to succeed.

35. The minutes of the 2018 AGM of the Company revealed that no progress had been made. In particular the claimants point to the fact that Dr Rogers stated that the directors had decided not to proceed with the legal review of the Company's IP which had been promised at the 2017 AGM. What is sadly evident from the tone of the minutes is that whilst everyone appeared to agree that, until the disputes between the claimants and certain other minority shareholders on the one hand and the defendants as directors and majority shareholders on the other hand were resolved, it was realistically impossible for the Company to raise funds and make progress, no compromise seemed to be achievable. Indeed, there is an email from the company which had been interested for some time in undertaking clinical trials in Brazil in which precisely the same point was made.

36. The reports for the year ended 30 June 2018 recorded that the Company remained unable to proceed to planned trials or new initiatives without further funds, adding that "without further funding within 12 months of signing [December 2018] the company is likely to become insolvent". It also referred to receipt of a letter before action from the claimants, saying that whilst it was believed the claim had no merit the disruption caused if permission was granted "may put the company at risk of insolvency".

37. The letter before action is that dated 22 August 2018. It included reference to the matters contained in the current claim as well as reference to various matters which did not feature in the claim as issued. It made clear that the principal relief claimed related to the complaints about the ownership of the IP generated since 1999 and to the complaints about the changes in that regard going forwards as introduced by the 2016 PLA. The defendants having after some delay instructed solicitors those solicitors provided a substantive response dated 16 November 2018. I do not propose to seek to summarise the welter of allegations and counter-allegations which were exchanged in the course of this and subsequent correspondence. It does not make edifying reading and I have no doubt that the whole process has been extremely time-consuming and expensive for both parties. I have been referred by both counsel to certain parts of the correspondence, which they submit support their respective case or detract from the case as advanced by the other side, and I take such matters into account as appropriate.

38. The claimants have provided a number of witness statements from other minority shareholders who indicate that they support the claim. These witness statements were made on various dates, principally in November or December 2018. The majority are either in the same or substantially the same terms and were clearly produced as a template by the claimants' solicitors for the witnesses either to sign unamended or to make amendments as they thought fit. They all say that they have been shown the draft Particulars of Claim, but do not make

reference to having been shown the pre-action correspondence including the defendants' response. Hence it cannot be assumed that they had seen the defendants' response to the claim. Nonetheless, there is no reason to believe that the statements do not represent the genuine view of those who made them.

39. On 15 March 2019 Dr Rogers wrote to all shareholders setting out her response to the allegations raised by the claimants. She suggested that until the legal dispute was resolved it was impossible to secure investment and that unless it was resolved within a matter of months the Company would "no longer be a going concern". She asked shareholders to provide written confirmation that they did not support further action. It would appear that the only response she received was from two individual shareholders, a Mr Adrian Wigan and a Mr Michael Wigan. This does rather indicate that there is no great groundswell of support for the defendants from the minority shareholders.

40. That concludes my summary of the facts and I now turn to address the relevant legal principles.

B. Relevant legal principles

41. There was no dispute of any substance as to the relevant legal principles to be applied, which are to be found in ss.260 - 263 CA 2006 as explained by subsequent case law, most comprehensively in the judgment of Lewison J in *Iesini v Westrip Holdings Ltd* [2009] EWHC 2526 (Ch).

42. It is common ground that the claimants are members of the Company and, thus, have standing to bring the claim under s.260(1). It is also common ground that the claim is one for relief on behalf of the company in respect of a cause of action arising from alleged breaches by a director of the Company and, thus, falls within s.260(3).

43. The court must not grant permission if it is satisfied that a person acting in accordance with s.172 CA 2006 (duty on company directors to promote the success of the company) would not seek to promote the claim: s.263(2)(a). This mandatory ground was considered by Lewison J in *Iesini* where he said this:

> "85. As many judges have pointed out (e.g. Warren J in *Airey v Cordell* [2007] BCC 785, 800 and Mr William Trower QC in *Franbar Holdings Ltd v Patel* [2009] 1 BCLC 1, 11) there are many cases in which some directors, acting in accordance with section 172, would think it worthwhile to continue a claim at least for the time being, while others, also acting in accordance with section 172, would reach the opposite conclusion. There are, of course, a number of factors that a director, acting in accordance with section 172, would consider in reaching his decision. They include: the size of the claim; the strength of the claim; the cost of the proceedings; the company's ability to fund the proceedings; the ability of the potential defendants to satisfy a judgment; the impact on the company if it lost the claim and had to pay not only its own costs but the defendant's as well; any disruption to the company's activities while the claim is pursued; whether the prosecution of the claim would damage the company in other

ways (e.g. by losing the services of a valuable employee or alienating a key supplier or customer) and so on. The weighing of all these considerations is essentially a commercial decision, which the court is ill-equipped to take, except in a clear case.

86. In my judgment therefore (in agreement with Warren J and Mr Trower QC) section 263 (2) (a) will apply only where the court is satisfied that *no* director acting in accordance with section 172 would seek to continue the claim. If some directors would, and others would not, seek to continue the claim the case is one for the application of section 263 (3) (b). Many of the same considerations would apply to that paragraph too."

44. s.172 CA 2006 provides that:

"(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others,
(d) the impact of the company's operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company."

45. A further mandatory ground for refusing permission is where the court is satisfied that the act or omission complained of was authorised by the company before it occurred: s.263(2)(c)(i). Although Mr Strelitz had submitted that this provision applied here, he was unable to point to any authorisation by a properly constituted general meeting of shareholders. I am satisfied that there is no prospect on the evidence before me of the defendants making out this mandatory ground.

46. In making its decision the court is required to take into account the particular factors identified in s.263(3), although this is not said to be an exhaustive list of the potentially relevant considerations. I refer now to those said to be relevant in this case.

47. Whether the member is acting in good faith in seeking to continue the claim: s.263(3)(a). Lewison J analysed this factor in *Iesini* at [115] to [120] by reference to the earlier authorities and to the wording of the sub-section. At [121] he considered the position where the claim was brought partly for the benefit of the company and partly for other reasons. He concluded that the pertinent questions to consider were whether the dominant purpose of the claim was to benefit the company and whether, but for the collateral purpose, the claim would not have been brought at all. At [122] he recorded that a person may be prevented from bringing a derivative claim if he had participated in the wrong of which he complains.

48. The importance that a person acting in accordance with section 172 (see above) would attach to continuing the claim; s.263(3)(b). The factors identified by Lewison J in *Iesini* at [85], referred to above, are of course relevant to this factor.

49. The merits of the case are plainly relevant to this discretionary ground. Lewison J considered in *Iesini* at [79] to what extent the court at this stage should investigate the strength or weakness of the case. He said this:

> "79. However, in order for a claim to qualify under Part 11 Chapter 1 as a derivative claim at all (whether the cause of action is against a director, a third party or both) the court must, as it seems to me, be in a position to find that the cause of action relied on in the claim arises from an act or omission involving default or breach of duty (etc.) by a director. I do not consider that at the second stage this is simply a matter of establishing a prima facie case (at least in the case of an application under section 260) as was the case under the old law, because that forms the first stage of the procedure. At the second stage something more must be needed. In *Fanmailuk.com v Cooper* [2008] EWHC 2198 (Ch) Mr Robert Englehart QC said that on an application under section 261 it would be "quite wrong … to embark on anything like a mini-trial of the action". No doubt that is correct; but on the other hand not only is something more than a prima facie case required, but the court will have to form a view on the strength of the claim in order properly to consider the requirements of section 263 (2)(a) and 263 (3)(b). Of course, any view can only be provisional where the action has yet to be tried; but the court must, I think, do the best it can on the material before it."

50. Whether the act or omission complained of gives rise to a cause of action which the member could pursue in his own right: s.263(3)(f). The cause of action most commonly identified is an unfair prejudice petition under s.994 CA 2006. This was considered in two cases to which my attention has been drawn. The first is the decision of Roth J in *Stainer v Lee* [2010] EWHC 1539 (Ch), where he referred at [51] to the "fundamentally different nature of the two forms of proceedings", emphasising in particular that under s.994 what a petitioner really wants is to be bought out, as opposed to seeking a remedy on behalf of the company for misconduct by its directors. The second is the decision of HHJ Cooke sitting as a High Court Judge in *Hook v Sumner* [2015] EWHC 3820 (Ch). That case is relied upon here by Mr Harper because the judge also considered, in the context of the particular facts of that case, an argument by the defendants that if permission was granted they would simply stop work and the company

would obtain no future income. This part of his judgment is at [107] – [109]. He concluded that it was necessary to take a commercial view as to whether or not the potential benefits from the continuation of the action (including the prospect of settlement) outweighed the potential damage to the company from the risk of the defendants downing tools.

51. s.263(4) provides that: "In considering whether to give permission (or leave) the court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter." Both parties rely upon the discretionary factor here.

C. Evaluation of the strength, size and importance of the claims

52. In my judgment these factors are of critical importance in this, as in many, cases. The claims are those set out in the Particulars of Claim, bearing in mind that the case as pleaded is not necessarily set in stone at this stage. Without undertaking an unnecessarily lengthy analysis of that statement of case it is possible to identify the following substantive claims:

53. A claim ["**the IP claim**"] that the 2005 and 2014 patents and all other IP relating to improvements under the 1999 PLA and the 2016 PLA are property to which the Company and not Dr Rogers is legally and beneficially entitled [paragraph 25.4] on the basis that: (a) this was so on a proper interpretation of the 1999 PLA and the circumstances in which the 2005 and 2014 patents and improvements came to arise; (b) this ought also to have been so for the future had the 2016 PLA adopted the same terms as the 1999 PLA as it ought to have, had the defendants properly complied with their duties as directors.

54. A claim ["**the alternative IP consequential loss claim**"] that if the 2005 and 2014 patents and all other IP relating to improvements under the 1999 PLA are not property to which the Company rather than Dr Rogers is legally and beneficially entitled, then the Company has suffered loss because of the defendants having caused the Company to act on the basis that it was so entitled, and specifically:

(1) The Company has applied for and obtained tax relief for R&D in the sum of circa £668,000 which "may be inappropriate on the grounds that the Company had not conducted such R&D on its own behalf in relation to IP which it owned", in which case the Company could incur a significant tax liability [paragraph 25.8.1]; and

(2) Dr Rogers and Ms Pambakian ought to have submitted tax declarations for benefits in kind on the basis that Dr Rogers was the "sole personal beneficiary" of the R&D expenditure of circa £8.2 million by the Company and of the monies expended for patent registration and maintenance, and that any tax assessment "could be" assessable on the Company as well as Dr Rogers [paragraph 25.8.2]; and

(3) Dr Rogers and Ms Pambakian had caused the Company to submit EIS declarations against which investors in the Company had successfully claimed EIS reliefs which, if

inappropriate, would lead to them suffering loss in respect of which the Company would be "likely to face claims" [paragraphs 25.9 and 25.10].

55. A claim ["**the excessive royalties claim**"] that the royalties which will be payable to Dr Rogers in case of any future sub-licences by reason to the drafting changes made in the 2005 side letter and the 2016 PLA are disproportionate and excessive [paragraph 31(a),(b),(f) and (g)].

The strength, size and importance of the IP claim

56. This claim has two logically separate, albeit connected, limbs. The first complaint in chronological terms is that the 2005 and 2014 patents ought not, given the terms of the 1999 PLA and the SA and the circumstances in which the inventions the subject of the patents came to be discovered, to have been applied for and granted in the name of Dr Rogers as opposed to the Company ["**the patents ownership claim**"]. The second complaint chronologically is that the defendants were responsible for making material changes to the terms of the 2016 PLA when compared with the 1999 PLA in relation to the ownership of improvements which were materially and manifestly disadvantageous to the Company when compared with the 1999 PLA ["**the improvements ownership claim**"].

The strength of the patents ownership claim

57. In my view, whilst neither the claimants nor the defendants have produced decisive evidence on this issue, the claimants appear to have the better of the arguments on the basis of the evidence before me.

58. Thus the claimants' case is predicated on: (a) their case as to the wide-ranging entitlement of the Company to the IP in the improvements under the 1999 PLA by reference to a proper construction of the terms of the 1999 PLA and the terms of the SA; (b) inference from the evidence that it was the Company which funded the R&D, including clinical trials, which has resulted in the improvements and thus the discovery of the IP; (c) their case that the involvement which Dr Rogers had in such respects can only have been in her position as consultant to the Company; and (d) the absence of any detailed evidence from Dr Rogers to the effect that she discovered the IP in circumstances in which she would clearly be entitled to ownership under the terms of the 1999 PLA.

59. These are all strong points in my judgment. However the claimants have not yet, whether themselves or through expert evidence, provided a detailed explanation as to how the inventive processes the subject of the patents arises out of the subject matter of the R&D as funded by the Company since 1999 and Dr Rogers' contributions thereto and as to how that inventive process falls within the scope of the definition of improvements.

60. In contrast the defendants' case is predicated on: (a) an interpretation of the 1999 PLA and a submission that the SA is either of no real assistance to the claimants in relation to the position

before 2013 and not in force after that date; (b) her evidence as to the circumstances in which the improvements the subject matter of the Patents were discovered.

61. In my view the defendants' case as to the interpretation of the 1999 PLA and rejection of the relevance of the SA is not particularly compelling. In my view it does not follow from the fact that the 1999 PLA envisages that there may be circumstances in which improvements as defined will nonetheless result from Dr Rogers' own work alone that it must also have been envisaged that this could occur in any, let alone a wide variety of, circumstances, including all circumstances in which the discovery was made by Dr Rogers working alone in her study one evening or weekend. It is not necessarily sufficient in my view for the claimants to say that because: (a) the material which was the basis for the inventive process was commissioned and paid for by the Company; (b) Dr Rogers was engaged as a consultant for the Company at the time, it must follow beyond argument that the inventive process must have arisen from its work so as to be its property under the 1999 PLA.

62. Nonetheless it is clearly the case in my judgment that Dr Rogers, as the person who knows most about these matters, has failed to adduce convincing detailed evidence as to the circumstances in which the improvements are said to have been discovered by her acting alone and not under the SA. Given the wide definition of improvements in the 1999 PLA the crucial question in my view is whether or not the inventive processes the subject matter of the patents are: (a) improvements, modifications or adaptations to any part of the existing IP; and (b) whether they might reasonably be of commercial interest in the development of the (widely defined) products. My assessment at this stage is that, given the wide terms of the provisions relating to improvements and given that Dr Rogers has not clearly explained how the inventive processes the subject of the patents are completely unrelated to the earlier patent or of no commercial interest in the development of the products, the defendants will face an uphill battle at any trial in making good their case.

63. Moreover, Mr Harper drew to my attention the plainly erroneous argument by the defendants' former solicitors, in their pre-action letter of response, that the 1999 PLA provided for Dr Rogers to have ownership of any improvements and the further explanation that insofar as the 1999 PLA and the SA did not reflect the true intentions of the parties those intentions were more clearly recorded in the 2016 PLA. He submitted that this might well provide the explanation as to why Dr Rogers acted as she did, both as regards applying for the subsequent patents in her own name and as regards the changes to the definition of improvements in the 2016 PLA. I accept the force of this forensic submission.

64. However, there some factors which militate against the claimants' case. The most significant, in my view, is that no-one, and Mr Walker in particular as the non-family board member and the finance director, appears ever to have challenged Dr Rogers' applications to register the patents in her own name rather than in the name of the Company and nor did the claimants appear to have challenged in 2016 her statement, in the context of the terms of the draft 2016 PLA, that she was the owner of the patents. Whilst it may be said that the former was because Mr Walker was kept in the dark, and the latter was because the claimants were unaware of the

true position in 2016, resolution of these issues would depend on an examination at trial of the evidence of the claimants and Mr Walker, and might turn out to be significant points in the case, insofar as there are live disputes of fact as to whether or not the improvements were or were not, given their nature and the circumstances of their discovery, to be the property of the Company or of Dr Rogers under the terms of the 1999 PLA and the SA.

65. There is a further issue to which Mr Strelitz drew my attention, which is that a claim under s.37 of the Patents Act 1977 to determine who is the true proprietor of a patent is subject to a strict 2 year limitation period from the date of grant of the patent, unless it is shown that the registered proprietor knew at the time of the grant that (s)he was not entitled to it. No submissions were made to me on the question as to whether that means actual and subjective knowledge or constructive or objective knowledge, although the former would appear more likely on the basis of the wording alone. Even if constructive or objective knowledge is sufficient, that is manifestly a further hurdle for the claimants to surmount in any claim that the Company ought to be registered as proprietor of the patents. I accept however Mr Harper's submission that this would not appear to bar the claim by the Company that it ought to be declared to be at least the beneficial owner of the IP. Indeed Mr Harper went further and submitted that the Company could deploy the ancillary terms of the 1999 PLA and SA to obtain an order requiring Dr Rogers to transfer the patents to the Company without having to ask the court to exercise its declaratory jurisdiction in relation to the ownership of patents, but that is not a matter on which I was referred to authority and I do not think that I can express a clear view on the point one way or another. It suffices to say that these are plainly obstacles to a successful claim which cannot summarily be discounted.

66. Moreover, it must be borne in mind that the answer to the question is not a simple binary one, i.e. that the patents either belong to Dr Rogers or to the Company. As provided by clause 10.5 of the 1999 PLA, if the IP in improvements arose from work carried out jointly by them it would be jointly owned. Although the claimants also sought to rely on clause 11.5 of the SA in support of an argument that even if the IP belonged to Dr Rogers the Company had the right to be notified of it and to exercise a right to acquire it from her, that would be a very different claim from the one actually advanced.

The strength of the improvements ownership claim

67. Again, I consider that the claimants have the better of the arguments, at least in terms of their principal complaint. It cannot be gainsaid that the relevant terms of the 2016 PLA are less favourable to the Company than those of the 1999 PLA, since Dr Rogers obtains the right to all improvements, even if they emanate from R&D undertaken or commissioned and paid for by the Company and even if they are discovered by her whilst working as a paid consultant to the Company. Although there is clear evidence, to which I have referred above, that both the claimants and the solicitors who they introduced were aware of these terms, there does not appear to be any equally clear evidence that they were aware that these terms differed materially from the terms of the 1999 PLA. Moreover, there is no suggestion that the changes were the subject of communication to or informed consent from the other shareholders. It

would appear from the evidence either that Dr Rogers took the view that the 1999 PLA had the same effect, even though it plainly did not, or she took the view that the 1999 PLA did not reflect the rights which she wanted to have over all IP arising from improvements and that the 2016 PLA should be drafted so that it accorded with what she wanted.

68. What was not the subject of specific submission during the hearing and what I am less sure about is what remedy would be available to the Company against the directors for causing the Company to enter into the 2016 PLA on less favourable terms than the 1999 PLA on the assumption that the court also found that this amounted to a breach of their duties as directors to the Company. The question is whether the court would have jurisdiction to declare, as is pleaded, that the terms of the 2016 PLA are either invalid or unenforceable, or that the Company is legally and beneficially entitled to all improvements made under the 2016 PLA, as is sought by the Particulars of Claim. If not, then it would appear that the only remedy available to the Company would be an award of damages or equitable compensation, which at present would appear to be entirely speculative. In his skeleton argument Mr Harper suggested that the consequence of findings in favour of the Company would be that the 2016 PLA would be voidable at the election of the Company; however even if that is what happened the consequence would simply be that the position would revert back to the 1999 PLA continuing on a rolling basis, which of course is what the claimants believed made the Company unattractive to investors in 2016. Whilst the minority shareholders might be able to pursue a s.994 claim on the basis that the defendants' conduct in executing the 2016 PLA in the terms they did and their refusal to unwind the transaction and enter into a new PLA on the same terms as the 1999 PLA was unfairly prejudicial to them, that of course is not the proper subject of a derivative claim.

The size and importance of the IP claim

70. It is clearly important when considering whether or not permission should be granted to attempt to ascertain the commercial value and benefit to the Company of pursuing the IP claim. No reasonable director would consider it worthwhile pursuing even a strong claim unless the benefit to be achieved justified the time, cost, risk and trouble. The claimants contend that the IP claim is of significant value and importance in two respects. The first is that unless the Company is the owner of the IP it will be unable to attract external investment to proceed to the next stage of clinical trials and thus proceed to bring the product to market. The second is that the IP has significant value in its own right as an asset which the Company is entitled to and should own, legally and/or beneficially.

71. However, I have struggled to find clear and compelling evidence from the claimants in support of either contention, save in the most general of terms. Thus:

 (1) Whilst Mr Glew refers, at paragraph 26 of his first witness statement, to the IP being the most valuable asset which the Company possesses, he does not provide any details or explain the difference between the value of the rights of full ownership and the value of

the rights under the 1999 and 2016 PLAs. The same lack of detail is apparent in paragraph 40.

(2) Whilst Mr Glew refers, at paragraph 103 of his first witness statement, to the defendants' conduct and the terms of the 2016 PLA as preventing the Company from being an "investable proposition" and, at paragraph 108, to the alleged misappropriation of the IP as being in his view the primary barrier to the Company raising new funding, again he does not provide any details or explanation as to the difference between the value of the rights of full ownership and the rights under the 1999 and 2016 PLAs (other than to refer to the excessive royalties claim, which is a separate issue and which I deal with separately below).

(3) Whilst Mr Glew's evidence is supported by Mr Walker who, referring to the discussions in 1999, said at paragraph 18 that if the Company did not own the IP that would have "negated" any possibility of fundraising, again that is a general statement and there is no positive evidence that Dr Rogers' ownership of the 2005 patent was a bar to further fundraising or that Mr Walker ever expressed himself in these terms at any time prior to his departure as a director and active participant in the Company in 2015.

72. Moreover, and importantly, there is no independent evidence from a valuer or from an investment adviser or from an interested investor to the effect either that: (a) the IP in itself has a substantial intrinsic value as an asset notwithstanding that the right to exploit the IP is enjoyed by the Company until it reverts back to Dr Rogers at the end of the 15 year term of the PLA, or that; (b) the Company's entitlement to the use of the IP without legal and/or beneficial ownership of the IP or any future improvements is in itself a real and insuperable impediment to securing substantial investment from external investors.

73. This omission cannot be explained by simple inadvertence, since the defendants' then solicitors observed in their letter of 18 January 2019 at [6] that the claimants had failed to show that "prospective investors have been discouraged from investment by the alleged dilution of the Company's rights as licensee".

74. Furthermore, I do not regard it as self-evident that Dr Rogers' "reversionary interest" in the IP has a significant value in itself. It must be remembered that patents, having a 20 year validity, are by definition wasting assets. What the Company needed in 1999 was the right to exploit the existing IP and any future improvements to the IP for a sufficiently long period to be able to develop and sell the products. Under the 2016 PLA, just as much as under the 1999 PLA, the Company has the exclusive right to use the patents and know-how (including – as appears from the definition of patent rights – any additional patents) for the same minimum 15 year term. Only the Company has the right to terminate before the minimum 15 year term had expired, save in case of insolvency.

75. And finally, as I have already said, the claimants clearly did not see Dr Rogers' ownership of the existing IP as an obstacle at the time they acquired their shareholding and entered into the

consultancy agreement with the Company, based on their expectation of securing funding. Their primary concern at the time was that the fixed term of the 1999 PLA had expired and that what was needed was a further long term PLA which gave potential investors sufficient assurance that the Company could safely proceed to develop and bring the product to market to enjoy a satisfactory return over the minimum term of the PLA and beyond, as they said in their letter of claim at [39].

76. It follows in my judgment that the claimants have failed to establish that the IP claim, whilst reasonably strong on my assessment of its merits, is either of substantial value as a claim in monetary terms or of real importance to the Company going forwards when compared with the position which it is already in under the existing 2016 PLA. This is plainly a very significant factor when deciding whether or not permission should be granted.

The strength, size and importance of the alternative IP consequential loss claim

77. This claim is pleaded expressly as an alternative to the claimants' primary case.

78. The defendants argue that this claim is misconceived, since the Company was properly entitled to undertake R&D in reliance upon the rights granted to it under the 1999 PLA, so that: (a) there is no question of the Company having improperly applied for and obtained tax relief; (b) the expenditure incurred by the Company was indeed for its benefit; and (c) the shareholders were entitled to claim EIS. In particular, the defendants draw attention to the position adopted by HMRC which was, they say, that: (a) before 2009, whilst there was an ownership requirement, that requirement was satisfied by reason of the rights granted under the 1999 PLA, because all that was required was that a company must have the potential to exploit the IP if it has use or value; (b) after 2009 there was no ownership requirement and, hence, no possible basis for challenge.

79. It is apparent that this case had not been fully investigated at the time the claim was issued, doubtless because it was pleaded very much as an alternative and in the qualified terms I have noted above. In paragraph 46 of his first witness statement Mr Glew rightly anticipated that such a claim would need proper underpinning to succeed, whether - as he suggested - by expert tax or accountancy evidence or otherwise, to support the case made both in terms of whether or not the approach taken by the Company was correct and the quantification of any claim. Moreover, as Mr Strelitz submitted, the claimants did not appear to have grappled with the objection that the treatment by the Company was not the subject of any adverse comment by Mr Walker or by the Company's auditors from 1999 onwards, and nor did it seemingly occur to the claimants themselves in 2016 (and where Mr Glew was an accountant with 28 years' experience) that given Dr Rogers' ownership of the patents it was not appropriate for the Company to be making these claims or taking this approach.

80. In his second witness statement Mr Glew recorded that since seeing Dr Rogers' witness statement in response he had taken advice from a tax lawyer on these points. However, he did not produce a copy of the advice and expressly declined to waive privilege in its content.

Nonetheless he continued to comment extensively and in some detail in his statement on the risks to the Company, saying that he felt it appropriate to do so based on his "experience", even though he accepted that he was not a tax expert, and his "enquiries", which seems clearly to be a euphemism for the advice he has taken which he is not prepared to disclose or to waive privilege in. In my view it is rather difficult for the court to place any real weight on that evidence in those circumstances.

81. In the circumstances it is also rather difficult to see how this case which it is sought to be brought against the defendants for breach of directors' duty can be thought to be anything other than essentially speculative. If the claimants' fears proved to be well-founded and if, as a result of the approach taken by Dr Rogers, it became clear that substantial losses would be or were actually suffered by the Company, whether as a result of claims by HMRC or by claims by investors or otherwise, then if the Company's position justified bringing a claim against the defendants as directors at that stage such claims might possibly be justified. However, there is no basis in my judgment for the claim to be advanced at this stage and nor is there any clearly demonstrated basis for the court to adjourn consideration of the application in respect of this claim.

The strength, size and importance of the excessive royalties claim

82. This claim depends initially upon the proper construction of the definition in question. I can see that the construction proposed by the claimants is tenable. However, there is no evidence so far as I am aware that the claimed effect of the changes to the definition of net sales value was ever intended by Dr Rogers, as opposed to being an unintended consequence of the wording used.

83. It was submitted by Mr Strelitz that Dr Rogers had always made it clear that she would never seek to contend that this was the effect of the alteration, if the point ever came where a product was developed and sales achieved by a sub-licensee. To put the matter beyond doubt I suggested that she might offer an undertaking and, after taking instructions, Mr Strelitz relayed to me that she was prepared to offer an undertaking that she would not seek to assert otherwise than as follows in respect of the 2016 Patent Licence Agreement: namely that her royalty rate under that licence agreement is 4.5% of the 'Net Sales Value' royalty received by the Licensee from sub-licensees or further sub-licensees thereof; or, where the Licensee transacts any sale then 4.5% of the 'Net Sales Value' from the Licensee's own sales.

84. There was no suggestion by Mr Harper that this was unsatisfactory and, in the circumstances and with that undertaking to be recorded in the minute of order which disposes of this matter, that means that there is no proper basis for granting permission as regards this head of claim.

D. Consideration of the relevant factors

85. It is convenient to consider s.263(2)(a) and s.263(3)(b) CA 2006 together, since both require the court to consider whether the hypothetical director acting in accordance with s.172 CA

2006 would continue the claim by reference to the importance which he or she would attach to doing so.

86. Notwithstanding the low bar which is set by s.263(a) I am satisfied, for the reasons I have given above, that the mandatory ground for refusal is made out in relation to the alternative IP consequential loss claim and, given the undertaking which Dr Rogers will give, the excessive royalties claim.

87. The IP claim requires a careful consideration of the factors relevant to the decision by the hypothetical director. Clearly my finding that on the evidence before me the IP claim, whilst reasonably strong on the merits, has not been shown to be of substantial value or importance to the Company, is a significant one in this context.

88. A director would also consider the cost of the proceedings and the Company's ability to fund the proceedings. I have no doubt that the prosecution of the IP claim would be complex and expensive, even if prosecuted with an eye on time and cost and with the benefit of active case and costs management by the court. On the basis of the evidence and arguments examined at the hearing before me it would involve an investigation into the circumstances of the discovery of the inventive processes leading up to the applications for the 2005 and 2014 patents, which would involve an investigation into the history of the R&D undertaken by the Company from 1999 up to 2016, as well as an investigation into the circumstances in which the 2016 PLA came to be entered into. It would be necessary to consider the conduct of the defendants, and Dr Rogers in particular, to decide whether or not there was any breach of directors' duties and if so which and on what basis. It would also be necessary to consider with some care the appropriate remedy or remedies to which the Company was entitled, bearing in mind in particular the limitation period applicable to claims under s.37 Patents Act 1977. There are plainly a number of disputed issues of law and contract construction as well as issues of fact to consider. It is difficult to see how the IP claim could be resolved without extensive disclosure and witness evidence and, possibly, expert evidence, and without a trial of perhaps a week's duration. I would not have thought it likely that the whole process could be concluded within 12 months at the very earliest and probably longer.

89. Whilst of course the Company will only be required to fund the litigation if it is ordered to indemnify the claimants against the costs of the claim, either on a final basis or on a final and interim basis, the authorities such as *Iesini* indicate that the starting point is that where the court has determined that the claim should properly be brought as a derivative claim for the benefit of the Company it is ordinarily appropriate for an indemnity to be ordered. There has been some dispute as to the current financial position of the Company. In particular, there has been some question as to the fact that asserted expenditure on patent protection in the last 18 months has been significantly in excess of expenditure for such purpose in the previous two financial years. However both from the most recent accounts and from the bank statements produced disclosing the more recent position it is clear that its position is and has been for some time now poor. Whilst its expenditure is relatively low, it is not in receipt of any income,

not surprisingly since the only way it can generate income is by developing and exploiting the product.

90. The Company has been unable to raise funds for some time now and, whatever the reason or reasons for that difficulty, there is no indication that it will change in the short or medium term. It is common ground, and in any event clear, that there is no possibility of securing further investment into the Company whilst this dispute is ongoing. Although the claimants have offered to fund the cost of patent protection for 12 months on the basis of historical expenditure as revealed by the accounts, they have not undertaken to fund all reasonably necessary expenditure required by the Company, including the cost of this litigation up to judgment, to ensure that the Company does not become insolvent prior to that time. Whilst I do not criticise them for not so undertaking, nonetheless the only conclusion I can reach is that in all of the circumstances it is quite clear that the Company is not in a position to fund extensive and expensive litigation such as the claimants wish to commit it to bring.

91. Are the defendants in a position to satisfy any judgment? This issue is perhaps less important than in many cases since the remedy which the claimants seeks as regards the 2005 and 2014 patents is a vesting or declaratory remedy and since the claimants are also seeking declaratory relief in relation to the 2016 PLA. However if and insofar as these proprietary or declaratory remedies are not available, and if it is said that the consequence of the defendants' conduct is such as to have caused the Company substantial loss, there is no evidence of the defendants having independent wealth such as would enable them to pay substantial amounts, unless the Company itself successfully developed and exploited the products which, logically, would not be the case in such a hypothesis.

92. What about the disruption to the Company in the meantime? I have already said that without funding the Company cannot move forwards and whilst the dispute continues funding cannot be obtained. Mr Glew himself said in paragraph 48 of his first witness statement that until this issue is resolved the Company cannot move forwards to raise new funds.

93. It follows that if I grant permission the Company cannot move forwards until the dispute has been finally resolved. This dispute has already lasted for around 2 ½ years so far. In my judgment it is not in the interests of the Company that it should be stymied for a further significant time period in the absence of the clearest of evidence that there will be a significant benefit to the Company in pursuing the IP claim. If I refuse permission then the Company can move forwards and, in the absence of compelling evidence that it will be unable to raise funds due to the terms of the 2016 PLA, as to which there is none, it can do so on a clear basis.

94. Although the claimants can and do say that the evidence shows that the Company has been unable to move forwards for some considerable time anyway and regardless of this dispute, I do not regard this as a sufficient answer. By refusing permission at least one bar to moving forwards falls away. If, contrary to the view I have taken on the evidence before me, Dr Rogers' ownership of and entitlement to own further IP by Dr Rogers is a bar to further investment, then it would appear that the defendants would be cutting off their own noses to

spite their faces in refusing to take steps to resolve that bar. I acknowledge the risk that they might do so. However the plain fact is that for the last 2 ½ years this dispute and the uncertainty it has caused have stopped the Company from moving forwards and it is not desirable that this should continue for a further period unless clear and compelling reasons for doing so are shown, which they have not in my view. If the claimants also say, as they have done, that the continued management of the Company by the defendants is preventing it from moving forwards regardless of this dispute, that is not a proper aim of or justification for this derivative action.

95. For completeness, whilst there was some debate at the hearing about whether or not Dr Rogers would be prepared to devote time and money into the Company if permission was granted or if the substantive relief sought was obtained, I place no weight on this as a factor. If there is a strong claim, which the company ought to be pursuing against a delinquent director, then it is unlikely in my view that a threat by the director to walk away from the company out of pique will carry much weight with a court. That is particularly so in a case such as the present where, as I observed in argument, the only way that anyone will get any money out of the Company is if it develops a successful product, and the only way that will happen is if investment can be obtained. Since Dr Rogers will receive 4.5% royalty on any sales, and since the defendants and their family interests will receive in excess of 75% of any dividends, it would make no commercial sense for her to walk away even if permission was granted or the case succeeded. Since she also states that what has always motivated her as much as, if not more than, financial reward is to develop a successful cure for diabetes it is in her wider interests for the Company to succeed as well.

96. Having had regard to all of these factors relevant to the exercise of the discretion by the hypothetical director under s.172 CA 2006 I have decided – albeit with some hesitation – that I am satisfied that no such director would seek to continue the claim. In my judgment no reasonable director acting in accordance with s.172 could consider, notwithstanding the strengths of the IP claim, that it was in the interests of the Company to proceed with the claim notwithstanding the lack of clearly identified benefit and regardless of the problems that would cause the Company in the meantime. In any event I have also decided – with no hesitation at all – that considering all of the relevant factors a clear majority of such directors would conclude that it was not appropriate to risk the future success, and indeed the survival, of the Company by bringing a claim where it could not clearly be shown that its success would place the Company in a significantly better position than it would be in had the claim not been made.

97. As regards s. 263(3)(a) and s.263(3)(f), is in my judgment this is a case where the good faith of the claimants and the other remedies available to them and the other minority shareholders are of some, albeit not decisive, significance. I do not accept the defendants' submission that the claimants are acting in bad faith in that they are pursuing the claim entirely or principally for collateral purposes, or that they have acted in wholesale breach of their duties to the Company under the confidentiality agreements they entered into. Nor do I accept the submission that this is a clear case where a s.994 unfair prejudice claim is obviously the only appropriate remedy. However it is apparent to me, having read the voluminous correspondence and the witness

statements, that the claimants are clearly convinced that the defendants have acted in a significant number of ways contrary both to the interests of the company as a whole and to their own interests as shareholders who expected to be closely involved in driving the Company forwards to a successful future. They have made a significant number of complaints and have expressed themselves in strong and, I am satisfied, intemperate terms on a number of occasions. It is clear from the correspondence of 28 June 2017 and following that whilst the claimants' original aim was simply to persuade the defendants of the need to appoint themselves or others with suitable financial and business experience to the board, their ultimate aim has become to persuade the defendants to step down from management and, if possible, to buy them out as shareholders. In my assessment they are clearly influenced in part in bringing this litigation as a means to achieving these ultimate goals. These are relevant considerations even if, as the claimants are concerned that I record, the way in which the defendants have acted and expressed themselves are also capable of heavy criticism.

98. If the IP claim was not only a compelling case on the merits but also one which clearly needed to be brought, either because of the intrinsic reversionary value of the IP or because it was necessary for the IP to be brought under the Company's control to enable it to obtain external investment, or because without the dispute being resolved in its favour the Company could not otherwise move forwards, then these considerations would not have been fatal. But, given the views which I have formed about these matters, then the fact that the claimants are not proceeding purely through disinterest, where their ultimate ambition is either to secure the removal of the defendants from control or to obtain a buy-out, and where it would be at least feasible to pursue those claims in a s.994 action where permission could also be sought to include this claim, then these are factors which militate against granting permission.

99. Finally, I am required by s.263(4) to consider the evidence as to the views of the other members of the company who have no personal interest in the case. I do not regard the evidence on this point as particularly significant one way or another. That is because whilst it is clear that the defendants have been unable to assemble any real support from the minority shareholders, it is also clear that the claimants do not have the expressed support of all, or substantially all, of the minority shareholders. I know that 34 out of a total of 172 shareholders have provided witness statements. I am told that they represent 9.3% of the shareholders by value. I accept that this is a significant proportion of the minority shareholding. It appears that not all of the shareholders were approached, apparently because the claimants do not have contact details for all shareholders. I have been told that there were no adverse responses. However, I do not know what information they have been provided with and nor do I know whether their motives in supporting the claim are entirely disinterested or are identical to the claimants. Moreover, I do not regard this as being a case where the views of independent minority shareholders necessarily carries great weight in assisting the court to see whether the best interests of the Company are served by allowing the claim to proceed or by refusing permission. In this case it does not in my judgment countervail against the preponderance of the factors pointing firmly in my view in the opposite direction.

100. In summary, therefore, I am satisfied that a mandatory ground for refusing to grant permission is made out and I am also satisfied that even if that was not so I would not have exercised my discretion to permit the claim to be brought for substantially the same reasons, albeit taking a wider range of considerations into account.

E. Conclusions

101. Permission must therefore be refused.

102. In the circumstances I need not say anything about the question of an indemnity against costs, but for completeness and in case the matter proceeds further it may assist if I state briefly what I would have done had I concluded that the IP claim should be permitted to be brought.

103. As regards an indemnity against costs, as is well known the court has a discretion as to whether or not to order that the claimants ought to be indemnified by the company in respect of their costs and, if so, whether that should be a complete indemnity or limited either in amount or to a particular stage in the litigation, but that the default position is that if a court has determined that the case is appropriate to be brought for the benefit of the company then the claimants ought to be indemnified.

104. As Mr Harper submitted, making an order that there should be an indemnity does not mean that the claimants will necessarily be repaid all of their costs, since that would depend on whether or not the Company is in a position to repay costs as and when the claimants are entitled to call for an indemnity (and the court also has a discretion as to whether or not the claimants should be entitled to obtain payments on account of their costs).

105. Whilst I would have concluded that it would have been appropriate to order an indemnity it would not have been in unqualified terms. In particular, given the claimants' previous over-enthusiastic pursuit of claims and my view that the Company ought not at this stage be ordered to, and would indeed be unable to meet, the costs already incurred or to have to make interim payments of costs going forwards: (a) the indemnity would only have extended to such costs as were agreed or allowed by the court on detailed assessment, with there to be costs budgeting at which the claimants' estimated costs should be the subject of careful scrutiny; (b) the indemnity would not have extended to costs incurred thus far, save insofar as the trial judge determined at the conclusion of the case that it should; (c) there would be no right to obtain any interim payment from the Company on account of such costs.

106. Since the existing Particulars of Claim is not in my view a suitable vehicle for the pursuit of the IP claim by itself or to enable the defendants to know the full case made against them, it would have been necessary for the claimants to file and serve a substituted Particulars of Claim, making it clear whether or not a claim under s.37 Patents Act 1977 is being made and, if so on, what basis and, in particular, setting out the claimants' case as regards limitation rather than leaving it to a Reply.

107. I would also have considered it desirable that the parties should at the earliest opportunity have and take the opportunity to engage in mediation or other ADR. If both parties are genuine in their expressed desire for the venture in which the Company is engaged to succeed, both for financial reasons and to benefit humanity in the development of useful diagnostic tools and treatments for diabetes and other conditions, then they ought to be able to reach an amicable settlement rather than risk the failure of their joint venture.

108. Finally, if the claimants were to make a claim under s.37 Patents Act 1977 then it would appear that the case would have to be transferred to the Intellectual Property List, either to the Patents Court or to the Intellectual Property Enterprise Court, subject to the approval of the appropriate judge. That would also involve consideration as to whether or not the case should remain in and be tried in Manchester, if a suitable judge could be made available, or be transferred to the Rolls Building, which is where it appears to me at least it more naturally belongs given the location of the parties.

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Case No: BL-2020-MAN-000094

& CR-2020-MAN-000753

IN THE HIGH COURT OF JUSTICE

BUSINESS AND PROPERTY COURTS IN MANCHESTER

INSOLVENCY AND COMPANIES LIST (ChD)

Date: 22 January 2021

Before:

HIS HONOUR JUDGE PEARCE

- -

Between:

DANIEL ROGER HUGHES **Claimant**

- and -

(1) NICHOLAS JAMES BURLEY

(2) BURPROP LIMITED

(3) JONATHAN PAUL PHILMORE

(4) NIDA PROPERTIES LIMITED

Defendants

- -

- -

BRAD POMFRET (instructed by **Knights plc**) for the **Claimant**

JOHN VICKERY (instructed by **Irwin Mitchell LLP**) for the **First and Second Defendants**

MICHAEL BOWMER (instructed by **DWF Law LLP**) for the **Third Defendant**

Hearing date: 30 November 2020

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JUDGMENT

I direct that, pursuant to CPR PD 39A para 6.1, no official shorthand note shall be taken of this judgment and that copies of this version as handed down may be treated as authentic.

His Honour Judge Pearce:

Introduction

1. This is my judgment on the first of the issues that were listed before the court for hearing on 30 November 2020, namely whether the Claimant should have permission pursuant to Section 263 of the Companies Act 2006 ("the 2006 Act") to continue a derivative action on behalf of the Fourth Defendant against the First to Third Defendants in case number BL-2020-MAN-000094 ("the permission issue"). (It should be noted that, in the heading of some of the documents in this case, the case number has wrongly been given as CR-2020-MAN-000094.)

2. In this judgment, I largely use the parties' descriptions as in the title to that action. The Second Defendant is a company owed by the First Defendant and those two parties have the same representation. It is not necessary for the most part to distinguish between the arguments advanced on behalf of those two Defendants and the Third Defendant (whose interest is slightly different but who adopts the First and Second Defendants' case in so far as is relevant), and when in this judgment I use the term "Defendants", I do so meaning the First, Second and/or Third Defendant. In contrast, the Fourth Defendant, on whose behalf the derivative action is brought and which therefore for the purpose of this application has common cause with the Claimant, is at times described as "the Company".

3. As well as this application, the Court also has before it:

   (a) An application by the Claimant in CR-2020-MAN-000753 for inspection of accounting records pursuant to section 388(1)(b) of the 2006 Act;

   (b) An application by the First Defendant for an administration order in respect of the Fourth Defendant in BL-2020-MAN-000094;

   (c) An application against the First, Second and Third Defendants for disclosure by the Fourth Defendant in CR-2020-MAN-000094.

4. It is common ground that I should deal with the permission issue before determining the other applications. In the event, there was only time to hear submissions on the issue of

permission to continue at the hearing on 30 November 2020 and accordingly the other issues have been stood over until I have handed down judgment on the permission issue.

5. For the purpose of dealing with this application, I have the following witness statements:

   (a) From the Claimant, statements dated 13 August 2020, 13 October 2020 and 20 November 2020. (There are further statements from the Claimant dated 24 September 2020 and 2 November 2020, both dealing with disclosure issues.)

   (b) From the First Defendant, statements dated 3 August 2020, 5 September 2020 and 21 October 2020.

   (c) From the Third Defendant, a statement dated 11 November 2020.

Background

6. The Claimant is by profession an architectural consultant. He was involved in design and project management work in the redevelopment of the First Defendant's house between 2017 and 2019. Their experiences during this work led to an agreement to carry out further development projects. The First Defendant appears to have had substantial capital available to him, having sold his interest in a successful business and in September 2018 discussions began as to further work together.

7. The concept of the new business was that the First Defendant would provide the capital, whilst the Claimant would provide day-to-day project management. The vehicle for this business was to be a limited company in which they were to be directors and equal shareholders. The First Defendant would loan money to the company to enable it to fund the purchase and development of properties. The intention was that, upon completion and sale of the developed properties, the First Defendant would be repaid the amounts that he had loaned, together with interest at the rate of 5% per annum, and that, following repayment of any other costs and expenses, the Claimant and First Defendant would share the profit from the developments equally.

8. It is common ground that the Claimant was to draw £50,000 from the company. It is however in dispute whether this was, as the Claimant says, an annual salary, which was part of the development costs, or, as the First Defendant says, a director's loan, initially of up to £50,000, later increased to £75,000, to be repaid from the Claimant's share of the profits.

9. During the negotiations, the Claimant and First Defendant had a meeting with solicitors, Dootsons, on 3 October 2018. The attendance note of that meeting records various things of significance:

> "[The Claimant] *is currently carrying out work for* [the First Defendant] *and the large extension that has been done is not far off completion. They have decided to set up a joint venture to do similar work for other clients… They have identified a gap in the market between the small and big developers. They will buy in the name of a Company. Its initial share capital will be nominal. The deal will be financed by* [the First Defendant] *for a loan to the Company which will be secured on the property. The company will be a 50/50 shareholding. Services will be provided by Directors but there will be no obligation on Directors to provide any capital or services…"*

10. The Fourth Defendant was incorporated as the vehicle for the business on 19 October 2018. Three properties (collectively "the Properties") in Cheshire were identified and purchased:

    (a) In January 2019, Tabley Court, Knutsford ("Tabley Court");

    (b) In April 2019, West Road Garage, Weaverham ("Weaverham");

    (c) In October 2019, 49 – 53 Hob Hey Lane, Culcheth ("Hob Hey Lane").

    In the case of each, the First Defendant advanced funds that were secured by a charge upon the property. The terms of the charges are typical, but two of them deserve mention as relevant to issues in this case:

> "6.2 *At any time after this security has become enforceable or if at any time the property appears to the lender to be in danger of being taken in execution by any creditor of the mortgagor or to be otherwise in jeopardy, the lender may and without notice to the mortgagor:*
>
> > *6.2.1 appoint any person to be a receiver of the property or any part of it, and*
> >
> > *6.2.2 remove any such receiver, whether or not appointing another in his place,*
> >
> > *and may at the time of appointment or at any time subsequently fix the remuneration of any receiver so appointed*
> >
> > *…*
>
> *9 Neither the Lender nor any receiver appointed by the Lender, by reason of entering into possession of the Property, is to be liable to account as mortgagee in possession or for anything except actual receipts, or to be liable for any loss upon realisation or for any default or omission which mortgagee in possession might be liable."*

11. The First Defendant, at paragraph 11 of his first witness statement, sets out what he says was the financial plan for the Properties in broad terms as follows:

	Acquisition Price	Estimated Development Costs	Estimated Development Value	Gross Profit
Tabley Court	£1,298,000	£1,600,000	£3,900,000	£1,000,000
Weaverham	£563,000	£900,000	£2,000,000	£600,000
Hob Hey Lane	£1,168,000	£1,100,000	£3,100,000	£800,000
Total	**£3,029,000**	**£3,600,000**	**£9,000,000**	**£2,400,000**

The Claimant has not disputed these broad figures.

12. By 2020, there was some disagreement between the Claimant and the First Defendant about issues relating to budgeting and costs. The Claimant's case is that he considered it undesirable to have more than one development taking place simultaneously, unless in addition to his services, a quantity surveyor was employed. The First Defendant did not agree to this and as a result it was left to the Claimant and him to monitor costings. However, on the Claimant's case, the developments were progressing adequately and were broadly in line with expectations in the first quarter of 2020.

13. On the other hand, the First Defendant says that there were significant issues with the Claimant not providing the necessary information to review the progress of the developments. Further, he says that there was no significant progress in the projects from about October 2019 to February 2020 notwithstanding spending continuing at the rate of about £100,000 per month. By the end of this period, the First Defendant says, "*it was clear to me that the project was significantly over budget and behind timelines*" (paragraph 18 of his witness statement of 3 August 2020).

14. A meeting took place between the Claimant and First Defendant in either late February or early March 2020. The Claimant puts the date as 7 March 2020, the First Defendant as "*on or around 28 February 2020*" (paragraph 20 of the First Defendant's first statement). It appears likely that the Claimant's date is accurate, given an email from Ms Lauren Harrison, the First Defendant's daughter, who worked as a bookkeeper for the Fourth Defendant, dated 6 March 2020, which refers to providing relevant information "*to go through tomorrow*", this being an apparent reference to the meeting of which both the Claimant and the First Defendant speak, but at this stage it is neither possible nor necessary to make a finding in this regard. It is of note to the Claimant's case that Ms

Harrison says in the email, "*overall roughly in line with the plan…*" The Claimant relies upon this as evidence that there was no great issue about the costings.

15. Of the meeting (which, as I say, he dates as 7 March 2020), the Claimant says, "*when we discussed budgeting the next day, matters became quite heated, culminating in* (the First Defendant) *threatening to "withdraw funding". I said that I would discuss further once they both calmed down and left the meeting*" (paragraph 19 of the first witness statement). Thereafter, the Claimant says that his understanding was that he and the First Defendant agreed that a quantity surveyor should in fact be engaged and that developments were proceeding until the COVID-19 pandemic intervened. This led to a meeting on 19 May 2020, when the First Defendant said that "*he wanted to 'draw a line under this', by which he was obviously referring to our joint venture. He said that he had decided he wished to continue the business with his family*" (paragraph 21 of the Claimant's first witness statement).

16. The Claimant says that the First Defendant threatened to fight "*vigorously*" if the Claimant did not leave voluntarily and offered him £15,000 for his shares in the company, The Claimant further states that the First Defendant said that, if an agreement was not reached, he would put the company into liquidation. Whilst he accepts that discussions took place about the sale of the Claimant's shares, it was not possible to reach an agreement.

17. The First Defendant's account of the meeting was that he and the Claimant had a "*significant disagreement*" and, following the meeting agreed that they could not continue to work together, their ways of working being incompatible. They agreed to complete the projects but then cease working together. However, the COVID-19 pandemic meant that they had to close the sites in April 2020. The First Defendant says that he thereafter requested a deliverable plan from the Claimant to complete the developments, but that the Claimant repeatedly put off delivering such a plan and that therefore they needed to part ways forthwith.

18. The First Defendant says at paragraph 25 of his first statement, "*We both agreed that the company and the sites were less in present total value than the amount of the debt outstanding to me, but that the developed value ought to give a material profit. However, without my funding the project would not be deliverable*." The First Defendant therefore made two proposals in a discussion on 19 May 2020 – either the Claimant could sell his shares in the Fourth Defendant to the First Defendant; or the First Defendant would, in his capacity as creditor of the Fourth Defendant, demand repayment and seek to place the company into liquidation. Discussions followed in which the Claimant counter-proposed

that he be paid £100,000 for his shares in the Fourth Defendant. An agreement was reached that a payment of £25,000 be made to the Claimant in addition to his receiving the amount which, on the First Defendant's case, was outstanding on his loan account. This, on the First Defendant's case, gave a total value to the Claimant of about £80,000. However, this agreement required the Claimant to deliver up documentation relating to the developments. On the First Defendant's case, the Claimant was unwilling or unable to provide this and therefore the deal did not progress.

19. Pausing for a moment in the narrative, it is apparent that there is a very significant difference between the Claimant and the First Defendant as to what occurred in April and May 2020. The Claimant contends that his relationship with the First Defendant broke down essentially because of the First Defendant's unilateral decision to terminate their dealings in favour of carrying on the same business with members of his family. The First Defendant contends that the breakdown was due to the Claimant's inability to deliver upon the role of project management in the project. Again, it is not possible or necessary to make any factual findings. It suffices to note that, if the derivative claim proceeds, it is likely to involve highly contentious factual issues.

20. On 16 June 2020, the First Defendant appointed the Third Defendant, a licensed insolvency practitioner, as a fixed charge receiver over the Properties, pursuant to his securities. The Third Defendant explains in his witness statement that he is a director of a company called Philmore and Co Ltd. He has 30 years' experience in insolvency and has been a licensed insolvency practitioner for 20 years. He has extensive knowledge of insolvency in the building and construction industries. He confirmed, as stated by First Defendant, that, prior to this instruction, they did not know each other.

21. The Third Defendant sets out his analysis of the position at that time of his appointment within his witness statement. I summarise that as follows:

(a) The Fourth Defendant owed just short of £4.75 million to the First Defendant, a figure increasing by £25,000 per month on account of interest.

(b) Subcontractors on-site were owed approximately £190,000 as the latest fortnightly payment.

(c) Such fortnightly payments were likely to continue at a similar level for at least four months (eight fortnights).

(d) The Fourth Defendant had no security to offer to a third party funder.

(e) The Fourth Defendant was continuing to incur costs such as site security, insurance, receivership costs and interest.

(f) The Fourth Defendant's only source of money, the First Defendant, had withdrawn any further funding.

(g) There had been a breakdown in the relationship between the Claimant and the First Defendant.

22. The Third Defendant says that he decided against pursuing a marketing campaign for the following reasons:

(a) On any version of events there were insufficient realisable assets to discharge a liability to the First Defendant;

(b) Any potential purchaser would have a significant outlay to complete the properties given that they were in the middle of development;

(c) Pursuing a marketing campaign may have led to increased debts to subcontractors who might in turn have chosen to walk off site with consequent risk of deterioration of the site and delay;

(d) The Second Defendant was a willing buyer who could proceed quickly at what the Third Defendant considered to be a reasonable price.

23. The First Defendant offered to buy two of the Properties, Tabley Court and Weaverham, from the Fourth Defendant and subsequently purchased them through the Second Defendant, a company controlled by him, on 26 June 2020 (that is to say 10 days after the appointment of the Third Defendant). The Fourth Defendant also entered into a development agreement with the Second Defendant in respect of the property at Hob Hey Lane.

The Litigation

24. On 6 August 2020, the First Defendant made an administration application in respect of the Fourth Defendant in the proceedings entitled BL-2020-MAN-000094. That application was heard by me on 29 September 2020. Whilst I was satisfied that the Fourth Defendant was then insolvent and that the purpose of administration was reasonably likely to be achieved, as recorded in a preamble to the order, I declined to exercise my discretion to make an administration order given the Claimant's stated intention to issue a derivative claim. I therefore adjourned the application which, as identified above, remains stood over pending the outcome of the application for permission to bring a derivative claim.

25. In the meantime, on 24 September 2020, the Claimant had made a pre-action disclosure application against the First, Second and Third Defendants. That too remains stood over pending the outcome of the application for permission.

26. On 13 October 2020, the Claimant issued the instant claim and on the same day applied for permission to continue the derivative claim on behalf of the Fourth Defendant. That application came before me on 23 October 2020. On that occasion, I considered whether the Claimant was able to pass the first hurdle of the test for bringing a derivative claim and concluded that he was. I therefore gave directions to join the Third and Fourth Defendants to the application, with consequential directions for the service of evidence and the hearing on 30 November 2020.

27. In a further application issued on 2 November 2020, the Claimant sought inspection of the accounting records of the Fourth Defendant. Yet again, that application has been stood over for reasons identified above.

28. To date, the Defendants have not filed Defences (or produced draft Defences). However, each of the First, Second and Third Defendants have made clear, through evidence adduced in opposition to this application and in their skeleton arguments for the purpose of this hearing, that they deny the various claims against them on a variety of grounds.

29. It should be noted that the Claimant states at paragraph 13 of his statement of 13 October 2020, that he is "*prepared to continue to fund these proceedings on behalf of myself and the Company…"* The Third Defendant notes at paragraph 58 of his skeleton argument that "*there is no evidence before the court as to* [the Claimant's] *ability to fund the claimant which would give comfort to the reasonable director."*

The Claimant's pleaded case against the Defendants

30. The Claimant's pleaded case against the First Defendant is that the relationship between him and the First Defendant is not simply that of shareholders and co-directors in the Fourth Defendant, but is properly to be characterised as a joint venture agreement ("the Joint Venture Agreement") pursuant to which they agreed to conduct their business through the corporate vehicle of the Fourth Defendant. The Claimant asserts that he reposed "*a high degree of trust and confidence*" in the First Defendant and in particular pleads: "*Mr Hughes trusted that Mr Burley, in his capacity as funder of the development projects to be undertaken by the Company, would act consistently with the spirit and/or objectives of the Joint Venture Agreement and would not act contrary to the interests of the Company and/or Mr Hughes, who agreed to apply his skill and labour in expectation of an equal share of the profit on each development following completion and sale of the property concerned, which profit would not materialise unless Mr Burley provided*

sufficient funding to conclude the development in accordance with the Joint Venture Agreement."

31. In consequence of such a relationship, the Claimant pleads that the First Defendant owed fiduciary duties to him, as set out at paragraph 12 of the Particulars of Claim:

    (a) a duty of good faith;

    (b) a duty to be loyal to the Fourth Defendant and/or the spirit and/or objectives of the Joint Venture agreement;

    (c) a duty not to prefer his own interests over those of the Fourth Defendant and/or the Claimant;

    (d) a duty not to act, whether as a funder, charge holder or otherwise, such as to favour himself to the disadvantage of the Fourth Defendant and/or Claimant;

    (e) a duty not to act whether as a funder, charge holder or otherwise so as to frustrate or defeat the common purpose of the Joint Venture Agreement;

    (f) a duty to fulfil his obligation under the Joint Venture Agreement to provide the Fourth Defendant with adequate capital to develop the properties it chose to acquire.

    The Claimant alleges similar (although not identical) implied terms in the Joint Venture Agreement.

32. As regards the Fourth Defendant, the Claimant pleads that the First Defendant owed it the following duties:

    (a) a fiduciary duty of single-minded loyalty;

    (b) a duty pursuant to section 172 of the 2006 Act, to act in the way he considered, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole;

    (c) a duty pursuant to Section 174 of the 2006 Act, to exercise reasonable care, skill and diligence;

    (d) a duty pursuant to section 175 of the 2006 Act, to avoid a situation in which he had or could have a direct or indirect interest that conflicted or might possibly conflict with the interests of the Fourth Defendant;

    (e) a duty pursuant to section 177 of the 2006 Act to declare to other directors of the Fourth Defendant the nature and extent of any direct or indirect interest in a proposed transaction or arrangement with the Fourth Defendant.

33. At paragraph 45 of the Particulars of Claim, the Claimant pleads that the First Defendant is in breach of the Joint Venture Agreement. There are 15 sub-paragraphs of alleged particulars of breach, which can be summarised in 5 groups:

    (a) ceasing to fund the Fourth Defendant's development of the properties;

    (b) seeking to acquire and/or develop the properties for his own benefit and that of the Second Defendant, rather than the Claimant and the Fourth Defendant;

    (c) calling in his loans to the Fourth Defendant before completion of the developments;

    (d) appointing the Third Defendant as a receiver when the security was not in jeopardy and/or would not have been in jeopardy but for his own actions in failing to fund the continuing development;

    (e) applying for an administration order in respect of the Fourth Defendant in his own interests but to the disadvantage of the Claimant and the Fourth Defendant.

34. The Claimant goes on to plead that the Fourth Defendant is entitled to claim relief in respect of the alleged breaches of the Joint Venture Agreement by the First Defendant pursuant to the Contracts (Rights of Third Parties) Act 1999 ("the 1999 Act"), since he and the First Defendant had intended to confer the benefits of the agreement on the Fourth Defendant.

35. In respect of the duties owed to the Fourth Defendant, the Claimant contends that the First Defendant was in breach in 14 respects particularised at paragraph 48 of the Particulars of Claim. They can be grouped as follows:

    (a) acquiring and/or developing the properties for the benefit himself and/or the Second Defendant, rather than for the benefit of the Fourth Defendant;

    (b) calling in the loans, appointing a receiver and/or seeking an administration order in respect of the Fourth Defendant when the loans were not in default and/or the security was not in jeopardy (or would not have been in jeopardy but for the First Defendant's breaches of duty);

    (c) having decided to cease funding the Fourth Defendant, failing to investigate alternative means of funding to continue development of the properties;

    (d) using the commercially sensitive information of the Fourth Defendant for the benefit of himself and/or the Second Defendant in negotiating the purchase of the properties and/or the development agreement in respect of Hob Hey Lane;

(e) failure to disclose to the Fourth Defendant his conflict of interest which arose through negotiating on behalf of the Second Defendant;

(f) opposing the disclosure of information to the Fourth Defendant relating to his conduct in respect of the properties;

(g) incurring liabilities on behalf of the Fourth Defendant without authorisation from the Board of Directors;

(h) causing a payment of refunded VAT to be diverted from the Fourth Defendant to himself.

36. In respect of the claim against the Third Defendant, the Claimant pleads that he owed to the First and Fourth Defendants fiduciary and/or equitable duties of care and good faith, and a duty to take reasonable care to obtain the best price available when selling properties pursuant to the charge.

37. The Claimant contends that the Third Defendant breached those duties in that:

(a) He sold Tabley Court and Weaverham to the Second Defendant, a company controlled and owned by the First Defendant;

(b) He did not adequately or at all market the properties for sale;

(c) He did not adequately or at all investigate whether sale at a better price than that offered by the Second Defendant was available;

(d) He did not investigate whether the Claimant had a conflict as between his duties to the Fourth Defendant and his interest in the Second Defendant;

(e) He did not adequately investigate alternative purchasers and/or developers of the properties.

38. As against the First Defendant, it is alleged that he directed or interfered in the Third Defendant's actions which amounted to a breach of his duties to the Fourth Defendant and that therefore the First Defendant is liable to the company for those actions.

39. Finally, the Claimant alleges that the Second Defendant had actual knowledge of the First Defendant's and Third Defendant's breaches of duties and/or received the property of the Fourth Defendant unconscionably, such that it holds Tabley Court and/or Weaverham and/or the development agreement in respect of Hob Hey Lane on trust for the Fourth Defendant.

The Law – the permission application

40. Chapter 1 of Part 11 of the 2006 Act deals with the circumstances in which a derivative claim may be brought. Section 260(3) provides:

> *"A derivative claim under this Chapter may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company*."

41. The word "*default"* here would appear to have the same meaning as it was held to have by Griffiths LJ in Customs and Excise Commissioners v Hedon Alpha Ltd [1981] QB 818 at 827H (when considering the same word in the same phrase in section 448 of the Companies Act 1948, which refers to "*any proceeding for negligence, default, breach of duty or breach of trust against an officer of a company…"*), namely "*a failure to conduct himself properly as a director of the company in discharge of his obligations pursuant to the provisions of the Act of 1948."*

42. Where, as here, a member of a company brings a derivative claim, Section 261 of the 2006 Act deals with the procedure to be followed:

> "*(2) If it appears to the court that the application and the evidence filed by the applicant in support of it do not disclose a prima facie case for giving permission… the court -*
>
> *(a) must dismiss the application, and*
>
> *(b) may make any consequential order it considers appropriate.*
>
> *(3) If the application is not dismissed under subsection (2), the court -*
>
> *(a) may give directions as to the evidence to be provided by the company, and*
>
> *(b) may adjourn the proceedings to enable the evidence to be obtained.*
>
> *(4) On hearing the application, the court may –*
>
> *(a) give permission… to continue the claim on such terms as it thinks fit,*
>
> *(b) refuse permission… and dismiss the claim, or*
>
> *(c) adjourn the proceedings on the application and give such directions as it thinks fit."*

43. Thus, the court must consider an application for permission to bring derivative proceedings at a threshold stage, by determining whether the applicant makes out a prima facie case, and thereafter at a hearing. The threshold stage is usually dealt with on paper. In this case, that has not occurred as noted above, since the intention to bring derivative proceedings arose in the context of the application for an administration order and it was

convenient to consider the threshold stage at the adjourned hearing of the administration application on 23 October 2020. However, I should make clear that, whilst the Claimant was able to persuade me that he had a prima facie case sufficient to justify convening a hearing under Section 261(4), the fact that that decision was reached following a hearing at which the Claimant and the First Defendant were represented, rather than on paper, gives no greater authority to my decision that the Claimant had made out a prima facie case than would have been the case had I decided the issue on paper. It was simply a matter of convenience to deal with it in that way. This of course is of particular importance to the Third Defendant who was neither present nor represented at the hearing on 23 October 2020.

44. Section 263 of the 2006 Act provides:

> *(2) Permission (or leave) must be refused if the court is satisfied—*
>
> *(a) that a person acting in accordance with section 172 (duty to promote the success of the company) would not seek to continue the claim.*
>
> *...*
>
> *(3) In considering whether to give permission (or leave) the court must take into account, in particular —*
>
> *(a) whether the member is acting in good faith in seeking to continue the claim;*
>
> *(b) the importance that a person acting in accordance with section 172 (duty to promote the success of the company) would attach to continuing it;*
>
> *(c) where the cause of action results from an act or omissions that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be, (i) authorised by the company before it occurs or (ii) ratified by the company after it occurs.*
>
> *(d) Where the cause of action arises from an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company;*
>
> *(e) whether the company has decided not to pursue the claim;...*
>
> *(f) whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than on behalf of the company.*
>
> *(4) In considering whether to give permission (or leave) the court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter."*

45. Section 172 of the 2006 Act provides:

> *(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other things) to –*
>
> *(a) the likely consequences of any decision in the long term ,*
>
> *(b) the interests of the company's employees,*

> *(c) the need to foster the company's business relationships with suppliers, customers and others ,*
>
> *(d) the impact of the company's operations on the community and the environment ,*
>
> *(e) the desirability of the company maintaining a reputation for high standards of business conduct, and*
>
> *(f) the need to act fairly as between members of the company."*

46. The First, Second and Third Defendants contend in respect of the claims against each of them that permission must be refused pursuant to Section 263(2), but that even if they do not make out that mandatory ground of refusal, the court should not exercise its discretion in the Claimant's favour.

47. In undertaking the second stage of the procedure for considering applications for permission to bring a derivative claim, the Court should not conduct a mini trial but must form a view on the strength of the claim. As Lewison J put it in Iesini v Westrip Holdings [2011] BCLC 498 at [79]:

> *"I do not consider that at the second stage this is simply a matter of establishing a prima facie case (at least in the case of an application under section 260) as was the case under the old law, because that forms the first stage of the procedure. At the second stage something more must be needed. In Fanmailuk.com v Cooper [2008] EWHC 2198 (Ch) Mr Robert Englehart QC said that on an application under section 261 it would be 'quite wrong ... to embark on anything like a mini-trial of the action'. No doubt that is correct; but on the other hand not only is something more than a prima facie case required, but the court will have to form a view on the strength of the claim in order properly to consider the requirements of s.263(2)(a) and 263(3)(b)."*

48. The authorities also support the following principles:

    (a) Derivative claims are generally allowed to proceed in circumstances where otherwise a company's genuine claim might be stifled by the majority controllers of the company (see authorities cited in Hollington on Shareholders Rights, 9th edition, paragraph 6-07).

    (b) Derivative claims may be considered appropriate where a wrong is done to a company and a claim by the shareholders would be liable to fall foul of the so-called reflective loss of principle and the principle in Foss v Harbottle (see, for example, SDI Retail Services Ltd v King [2017] EWHC 737);

    (c) A Claimant is not disqualified from bringing a derivative claim simply because he may gain a collateral benefit from it - it is sufficient that the claim would benefit the company (see Iesini, op. cit. at paragraph 121);

(d) A person acting in accordance with Section 172 would have in mind many factors in deciding whether to pursue a claim, including:

i. The size of the claim;
ii. The strength of the claim;
iii. The cost of the proceedings;
iv. The company's ability to fund the proceedings;
v. The ability of the potential defendants to satisfy a judgment;
vi. The impact on the company if it lost the claim and had to pay not only its costs but the defendants' costs as well;
vii. Any disruption to the company's activities while the claim is pursued;
viii. Whether the prosecution of the claim would damage the company in other ways, such as by losing the services of a valuable employee or alienating a key supplier or customer.

(see Iesini, op. cit. at paragraph 85)

(e) Where the person seeking permission to pursue the derivative claim proposes to fund the action and does not seek any indemnity in respect of and adverse costs order, that is a relevant factor since it means that the litigation will not diminish the funds of the company available for distribution to members (Cullen Investments Ltd v Brown (2016) 1 BCLC 491, at paragraph 55);

(f) The weighing of the considerations that a person acting in accordance with section 172 would have in mind is essentially a commercial decision which the court is generally ill-equipped to take (see Iesini, op. cit. at paragraph 85);

(g) In undertaking the exercise required by section 263(3), the court is forming a provisional view of the merits of the case, including the likely quantum, doing the best it can on the basis of the evidence on paper, without the benefit of that evidence having been tested in cross-examination and without the parties having had the benefit of the disclosure of documents (see paragraph 36 of the judgment of Mark Anderson QC in Cullen Investments Ltd v Brown [2015] EWHC 473).

49. I would add to this list that the reference in section 172(1)(e) to maintaining a reputation for high standards of conduct in business must have the consequence that the hypothetical director would bear in mind that pursuing an unmeritorious claim, as well as potentially having adverse financial consequences for the company, might also adversely affect its reputation. This is likely to be of some significance where the person seeking to bring the derivative claim agrees to indemnify the company in respect of the costs of the claim, since the hypothetical director would not be concerned with potential economic

loss to the company caused by the litigation but must still have regard to the reputational consequences of such conduct. However, the usual detriments of pursuing unmeritorious litigation are financial rather than reputational and, where no question of an indemnity arises, the reputational risk might easily be outweighed by other commercial considerations in particular, the potential benefit of the litigation to the company.

50. The authorities cited include cases showing the decision of other judges in the application of the principles set out in Section 263(3). Whilst those examples are of interest, each case turns upon its own particular facts and circumstances.

The Law – the causes of action

51. Within this application, the court is of course not concerned with the merits of the Claimant's own claim against the First Defendant, since that is not a derivative claim governed by section 263. It is however concerned with:

(a) The derivative claim brought against the First Defendant on the grounds that the Fourth Defendant can rely on the Contract (Rights of Third Parties) Act 1999;

(b) The derivative claim brought against the First Defendant based upon the alleged breach of duties owed by him to the Fourth Defendant;

(c) The derivative claim brought against the Third Defendant based upon the alleged breach of duties owed by him to the Fourth Defendant.

52. In each of these areas, the Defendants have identified legal problems with the Claimant's analysis. Whether or not those issues are definitive and/or can properly be determined at this stage, a person acting in accordance with section 172 of the 2006 Act would undoubtedly bear such matters in mind. It is therefore appropriate to summarise the relevant law, before dealing with the parties' submissions on the issues.

A. Claims brought in reliance on the alleged breaches of duty owed by the First Defendant to the Claimant

53. The Fourth Defendant's right to bring such claims as a derivative claim depends upon it having the right to enforce the terms of a contract to which it was not a party. In this regard, the Claimant relies on Section 1(1) of the Contracts (Rights of Third Parties) Act 1999, which provides:

> *"Subject to the provisions of this Act, a person who is not a party to a contract (a 'third party') may in his own right enforce a term of the contract if—*
>
> …
>
> *a. subject to subsection (2), the term purports to confer a benefit on him.*"

54. For the purpose of analysing the duties allegedly owed to the Claimant, the Defendants divide them into the following groups:

    (a) an irrevocable obligation to fund the developments to completion;

    (b) fiduciary duties;

    (c) a duty of good faith.

55. The existence of the first of these gives rise to no particular legal issues (though considerable factual ones).

56. On the second group of duties, my attention is drawn to how Millett LJ defined a fiduciary in Bristol and West Building Society v Mothew [1998] Ch 1 at 18:

> "*A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary.*"

57. The relationship between Claimant and the First Defendant is that of shareholders. The Courts have been reluctant to find the existence of fiduciary duties in such circumstances. For example, in McKillen v Misland (Cyprus) Investments Limited [2012] EWHC 521 (Ch), David Richards J stated:

> *"94. In my judgment, a case that the shareholders owed each other fiduciary duties is not sustainable. Fiduciary duties arise where one person A holds property or exercises rights or powers for another, or for the benefit of another B. It is for that reason that A must deal with the property or exercise the rights or powers in the best interests of B and for the purposes which are properly within the scope of the power. It is for that reason that A owes a duty of loyalty to B and must not allow his duty to B to conflict with his own personal interests.*
>
> ...
>
> *97. Accordingly, trustees, directors, solicitors and agents will all owe fiduciary duties. So, also, will partners, even though each partner is jointly holding property or exercising powers for his own benefit as well as for the benefit of his partners. It is because he acts for his partners as well as for himself that a partner owes fiduciary duties to his other partners. By contrast, the shareholders in the company own their own shares for their own benefit and not for the benefit of others. Likewise, all the rights and powers conferred on them by the Shareholders' Agreement and the Articles of Association belong to them personally.*"

58. Again, in Al Nehayan v Kent [2018] EWHC 333 (Comm), Leggatt LJ stated:

> "*157. In considering this submission, I bear in mind that it is exceptional for fiduciary duties to arise other than in certain settled categories of relationship. The paradigm case of a fiduciary relationship is of course that between a trustee and the beneficiary of a trust. Other settled categories of fiduciary include partners, company directors, solicitors and agents. Those categories do not include*

shareholders, either in relation to the company in which they own shares or to each other."

59. But, as the decision in Ross River Ltd v Waveley Commercial Ltd [2013] EWCA Civ 910 shows, fiduciary duties can be owed between commercial co-venturers. In Glenn v Watson [2018] EWHC 2016 (Ch), Nugee J summarised the position thus at paragraph 131:

> *"(1) There are a number of settled categories of fiduciary relationship. The paradigm example is that of trustee and beneficiary; other well-settled examples are solicitor and client, agent and principal, director and company (subject to the impact of the Companies Act 2006), and the relationship between partners: Snell's Equity (33rd edn, 2015) at §7-004.*
>
> *(2) Outside these settled categories, fiduciary duties may be held to arise if the particular facts warrant it. Identifying the circumstances that justify the imposition of fiduciary duties has been said to be difficult because the courts have consistently declined to provide a definition, or even a uniform description, of a fiduciary relationship: ibid at §7-005.*
>
> *(3) Fiduciary duties will not be too readily imported into purely commercial relationships. That does not mean that fiduciary duties do not arise in commercial settings – indeed they very frequently do, as the example of agency illustrates – but that outside the settled categories, this is not common, it being normally inappropriate to expect a commercial party to subordinate its own interests to those of another commercial party: ibid.*
>
> *(4) A joint venture is not one of the settled categories of relationship giving rise to fiduciary duties between the joint venturers. Although at first sight the analogy with a partnership might suggest that it would be, it is clearly established that the phrase "joint venture" is not a term of art either in a business or in a legal context, and each relationship which is described as a joint venture has to be examined on its own facts and terms to see whether it does carry any obligations of a fiduciary nature: Ross River Ltd v Waveley Commercial Ltd [2013] EWCA Civ 910 ("Ross River") at [34] per Lloyd LJ.*
>
> *(5) The default position is that no such fiduciary duties arise. In the absence of agency or partnership, it would require particular and special features for such fiduciary duties to arise between commercial co-venturers: Crossco No 4 Unlimited v Jolan Ltd [2011] EWCA Civ 1619 at [88] per Etherton LJ. Examples of cases where, exceptionally, fiduciary duties have been held to arise are the decision in Ross River itself; that of Etherton J in Murad v Al-Saraj [2004] EWHC 1235 (Ch) ("Murad") (appealed, but not on this point: [2005] EWCA Civ 959 at [4]); and that of Peter Smith J in J D Wetherspoon plc v Van de Berg & Co Ltd [2009] EWHC 639 (Ch) ("Wetherspoon"). In Wetherspoon one director of the defendant company was found to have owed a fiduciary duty but the other two not, and it was said by Lloyd LJ in Ross River at [37] to be a good illustration of the proposition that the existence of a fiduciary duty in such a case is very fact-sensitive. With these can be contrasted two recent cases in which fiduciary duties have been held not to arise between co-venturers: Baturina v Chistyakov [2017] EWHC 1049 (Comm) (Sue Carr J), and Cullen Investments Ltd v Brown [2017] EWHC 1586 (Ch) (Barling J) ("Cullen"), a case coincidentally involving Mr Watson.*

(6) What then are the particular factual circumstances that will lead to the Court finding that fiduciary duties are owed? This can best be elucidated by a number of citations: (a) In his well-known classic judgment in Bristol & West Building Society v Mothew [1998] Ch 1 ("Mothew") at 18A, Millett LJ said: "A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence." (b) In Arklow Investments Ltd v Maclean [2000] 1 WLR 594 at 598G, Henry J, giving the judgment of the Privy Council, said: "the concept encaptures a situation where one person is in a relationship with another which gives rise to a legitimate expectation, which equity will recognise, that the fiduciary will not utilise his or her position in such a way which is adverse to the interests of the principal." (c) In F&C Alternative Investments (Holdings) Ltd v Barthelemy (No 2) [2011] EWHC 1731 (Ch) at [225], Sales J said: "Fiduciary duties are obligations imposed by law as a reaction to particular circumstances of responsibility assumed by one person in respect of the conduct of the affairs of another." (d) In another case involving Ross River Ltd, Ross River Ltd v Cambridge City Football Club [2007] EWHC 2115 (Ch) (cited by Lloyd LJ in Ross River at [56]-[58]), Briggs J referred at [198] to: "well known badges or hallmarks of a fiduciary relationship, such as ... [if] the plaintiff entrusts to the defendant a job to be performed, for instance, the negotiation of a contract on his behalf or for his benefit." (e) In Ross River at [51]-[52] Lloyd LJ cited with approval a passage from Bean, Fiduciary Obligations and Joint Ventures (1995) (itself referring to Finn, Fiduciary Obligations (1977)), which is too long to set out in full but the essence of which is as follows: "[Fiduciary] office holders are entrusted with power to act for the benefit of another, but are not under the immediate control and supervision of the beneficiary... Finn's rationale is that the fiduciary who has freedom to determine how the interests of the beneficiary are to be served requires the supervision of equity. Indeed, it is the fiduciary's autonomy in decision-making that requires equity's supervision and this is required whether or not the autonomy is created under a contract between the parties or is inherent in the office."

(7) Without in any way attempting to define the circumstances in which fiduciary duties arise (something the courts have avoided doing), it seems to me that what all these citations have in common is the idea that A will be held to owe fiduciary duties to B if B is reliant or dependent on A to exercise rights or powers, or otherwise act, for the benefit of B in circumstances where B can reasonably expect A to put B's interests first. That may be because (as in the case of solicitor and client, or principal and agent) B has himself put his affairs in the hands of A; or it may be because (as in the case of trustee and beneficiary, or receivers, administrators and the like) A has agreed, and/or been appointed, to act for B's benefit. In each case however the nature of the relationship is such that B can expect A in colloquial language to be on his side. That is why the distinguishing obligation of a fiduciary is the obligation of loyalty, the principal being entitled to "the single-minded loyalty of his fiduciary"(Mothew at 18A): someone who has agreed to act in the interests of another has to put the interests of that other first. That means he must not make use of his position to benefit himself, or anyone else, without B's informed consent.

(8) This analysis also explains why fiduciary duties will not readily be found in commercial settings. In commercial dealings the relationships are (usually) primarily contractual; and it is of the essence of commercial contracts that each party is (usually) entitled, subject to the express and implied constraints of the contract, to seek to prefer his own interests, and is not obliged to put the interests of the other party first.

> *(9) So far as joint ventures are concerned, fiduciary duties may in particular be found to arise where one party has control of assets which are to be exploited for the joint benefit of both. Thus for example in John v James [1991] FSR 397 at 433 Nicholls J said of a publishing agreement: "The copyrights were to be assigned to the publisher, and to become its property, but with the intention that they would be exploited by the publisher, which would have complete control over the method of exploitation, not for its benefit alone but for the joint benefit. Thus, commercially, the arrangement was in the nature of a joint venture, and the writers would need to place trust and confidence in the publisher over the manner in which it discharged its exploitation function." And in Ross River Lloyd LJ (who said at [62] that John v James was the most useful and compelling analogy) described it at [55] as: "a clear and instructive example of a transaction in the nature of a joint venture where the relevant assets belong legally and beneficially to one party, whose task it is to exploit them, but they are to be exploited for the common benefit of both parties, and where fiduciary duties arose from the situation despite the fact that the operator had its own personal interest in the exploitation to which it was entitled to have regard."*

> *(10) Even if a party is held to have owed a fiduciary duty to another party, the nature of the fiduciary obligations owed is itself a fact-sensitive enquiry, to be determined by considering the particular relationship between the parties: Ross River at [64]. Thus for example in John v James the defendants were not disposed to dispute that the publisher owed a fiduciary obligation to account for royalties received, but it was disputed, and had to be decided, whether it owed a fiduciary obligation in respect of exploitation of the copyrights; in Ross River Morgan J had found that the defendants owed fiduciary duties in certain respects but not others, and the Court of Appeal found that the duties were more extensive."*

60. As to the third issue, the alleged duty of good faith, Leggatt LJ stated in paragraph 172 of Al Nehayan v Kent cited above, that such duties may often be apposite to those involved in joint ventures. He cites with approval paragraph 11.17 of Hewitt on Joint Ventures (6th edition), where the authors state:

> "*If findings of fiduciary duties in the fullest sense between joint venture parties will continue to be rare, principles relating to "good faith" seem to fit a relationship between parties to a joint-venture where mutual trust and commitment are crucial to the success of the venture – and often explicit in the terms of establishing the relationship at the outset."*

61. The extent of any duty of good faith, where it exists, has to be kept within reasonable bounds. In Al Nehayan v Kent, Leggatt LJ at paragraph 175 stated that, where such an obligation does exist, it has been summarised as "*…an obligation to act honestly and with fidelity to the bargain and an obligation not to act dishonestly and not to act to undermine the bargain entered or the substance of the contractual benefit bargained for; and an obligation to act reasonably and with fair dealing having regard to the interests of the parties (which will, inevitably, at times conflict) and to the provisions, aims and purposes of the contract, objectively ascertained. In my view, this summary is also consistent with the English case law as it has so far developed, with the caveat that the obligation of fair dealing is not a demanding one and does no more than require a party*

to refrain from conduct which in the relevant context would be regarded as commercially unacceptable by reasonable and honest people... In [Paciocco v Australia and New Zealand Banking Group Ltd [2015] FCAFC 50] *(at para 290) Allsop CJ also made the important point that:*

> *'The standard of fair dealing or reasonableness that is to be expected in any given case must recognise the nature of the contract or relationship, the different interests of the parties and the lack of necessity for parties to subordinate their own interests to those of the counterparty. That a normative standard is introduced by good faith is clear. It will, however, not call for the same acts from all contracting parties in all cases. The legal norm should not be confused with the factual question of its satisfaction. The contractual and factual context (including the nature of the contract or contextual relationship) is vital to understand what, in any case, is required to be done or not done to satisfy the normative standard.*'"

B. Claims brought in reliance on the alleged breaches of duty owed by the First Defendant to the Fourth Defendant

62. Like the previous group of claims, the Claimant relies in part on the existence of a fiduciary duty, namely a duty of loyalty. Otherwise he relies on various duties arising from his role as director pursuant to the 2006 Act, essentially to promote the success of the Company in good faith and not to divert business from the Company. The duties pleaded are largely statutory in nature and their existence is uncontroversial. The alleged duty of single-minded loyalty might be the subject of some controversy, though for the purpose of this application, the Claimant contends that it is at least arguable that the First Defendant owed a duty to the company along these lines.

C. Claims brought in reliance on the alleged breaches of duty owed by the Third Defendant to the Fourth Defendant

63. The duties of a receiver in the position of the Third Defendant are not contentious. They can be drawn from the judgments of the Court of Appeal in Silven Properties Limited v Royal Bank of Scotland plc [2004] 1 WLR 997 and Ahmad v Bank of Scotland [2016] EWCA 602 and are helpfully set out at paragraph 21 of Mr Bowmer's skeleton argument, as follows:

(1) A mortgagee is not a trustee of the power of sale for the mortgagor; the power is given for his own benefit;

(2) A mortgage therefore has an unfettered right to sell when he likes in order to obtain repayment of the debt and need not take account of the mortgagor's interests in deciding whether or when to sell;

(3) The court will not interfere with exercise of the power of sale or the timing of a sale because this might be disadvantageous to the mortgagor, nor because a short delay

might produce a higher price, nor because the mortgagor might be soon in position to redeem;

(4) A mortgagee owes a duty in equity to exercise the power of sale in good faith;

(5) If and when the mortgagee does decide to sell, he must take reasonable care to obtain a proper price at the date of sale;

(6) A mortgagee is not required to incur expense in improving the security in order to sell it at a higher price;

(7) A receiver is deemed to be the agent of the mortgagor who is solely responsible for the receiver's acts and defaults unless the mortgagee gives directions to the receiver or interferes with his conduct;

(8) A receiver owes a similar duty in equity to exercise his powers in good faith, and if he sells to take reasonable care to obtain a proper price;

(9) But, again, he is not obliged to incur expense in improving the security to sell it at a higher price;

(10) These duties may be excluded by clear wording in the mortgage deed.

64. The Third Defendant makes the following further points at paragraph 23 of Mr Bowmer's skeleton argument:

(1) The receiver's duty to take care to obtain the best price reasonably obtainable at the date of sale is a limited one - there is no duty to await or effect any increase in value or improvements and it is permissible to proceed with an immediate sale.

(2) A receiver is given a wide margin of professional discretion and flexibility. There are no prescriptive procedures or processes that must be followed, and a receiver will not be adjudged to be in default "*unless he is plainly on the wrong side of the line*" (per Eder J in Saltri III Ltd v MD Mezzanine [2012] EWHC (Comm) 3025 at paragraphs 128 and 137).

(3) The question whether appropriate value is obtained by a receiver is a commercial one to be viewed in round and practical terms (so that, for example, if a side-benefit is obtained for the mortgagor which is in addition to the price, that is part of the commercial context against which the question must be answered) (Saltri III at paragraph 138; and per Lord Scott in Newport Farm Limited v Damesh Holdings Ltd [2004] NZLR 721 (PC) at paragraph 24).

(4) For a Claimant to succeed with an allegation that there has been a breach of the duty of good faith on the part of a receiver "*requires more than negligence or even gross*

negligence: it requires some dishonesty, or improper motive or element of bad faith to be established" (Ahmad at paragraph 39(vi)).

(5) Where a receiver sells to a company in which the mortgagee has an interest, this does not give rise to any requirement that the receiver justify what he has done or bears the burden of proving that he has not breached his duties on account of any conflict of interest (per HHJ Paul Matthews in Devon Commercial Property Ltd v Barnett [2019] EWHC 70 (Ch) at paragraphs 27 and 194).

65. The final point relating to the burden of proof merits closer attention. In Tse Kwong Lam v Wong Chit Sen [1983] 1 WLR 1349, the Privy Council considered the position where a mortgagee exercised a right of sale under charge and then sold the property to his wife at auction. The borrower claimed against the mortgagee for the difference between the price paid for the property and the best price reasonably obtainable for it at the date of the sale, contending that the mortgagee had failed to show that he had taken reasonable precautions to obtain the best obtainable price. The Privy Council, in allowing the borrower's appeal against a decision dismissing his claim, stated at p. 1355A:

> "*In the view of this Board on authority and on principle there is no hard and fast rule that a mortgagee may not sell to a company in which he is interested. The mortgagee and the company seeking to uphold the transaction must show that the sale was in good faith and that the mortgagee took reasonable precautions to obtain the best price reasonably obtainable at the time.*"

Further in the judgment, the Board stated at page 1359H:

> *"A mortgagee who wishes to secure the mortgaged property for a company in which he is interested ought to show that he protected the interests of the borrower by taking expert advice as to the method of sale, as to the steps which ought reasonably to be taken to make the sale a success and as to the amount of the reserve. There was no difficulty in obtaining such advice orally and in writing and no good reason why a mortgagee, concerned to act fairly towards his borrower, should fail or neglect to obtain or act upon such advice in all respects as if the mortgagee were desirous of realising the best price reasonably obtainable at the date of the sale for property belonging to the mortgagee himself."*

66. This rule is described by the authors of Lightman and Moss on the law of Administrators and Receivers of Companies (6th Edn) at paragraph 13-47 as "a fair-dealing rule". At paragraph 13-048 they state that the same rule applies in the case of a receiver selling as agent of the mortgagor to a company in which the mortgagee has an interest. However, in Devon Commercial Property Ltd v Barnett, HHJ Paul Matthews doubted this expression of the principle, since the receiver and mortgagee are two persons and it is the mortgagee not the receiver who benefits from the putative sale at undervalue (see paragraph 28 of the judgment).

The Claimant's Submissions

67. The Claimant's starting position is to examine the relationship of the First Defendant and himself. Notwithstanding paragraph 21 of his third witness statement, in which the First Defendant firmly denies that he and the Claimant entered into a joint venture agreement, the Claimant notes that the First Defendant has himself described their relationship in a way that is liable to lead to a finding that there was such an agreement (see paragraphs 6, 7 and 9 of his first witness statement) and indeed described discussions about his willingness "*to fund a joint venture development business*" at paragraph 16.2 of his second witness statement. Further, the project was described as a "*joint venture"* in the attendance note prepared by Dootsons' solicitors following the meeting on 3 October 2018. The Claimant contends that this was a venture in which they were each investing, the First Defendant through the introduction of capital and the Claimant through the provision of his services. Subject to the exact nature of the payment of £50,000 per annum mentioned above, neither was to be paid during the development works, but only on their conclusion. Each had to be able to trust the other to see the developments through, otherwise they each risked loss if the projects were aborted. In those circumstances, the court might well find that they had entered into a joint venture agreement pursuant to which they owed duties, including fiduciary duties, to each other.

68. Turning to the First Defendant's motives for the termination of the relationship and the appointment of a receiver, the Claimant contends that the evidence does not support the First Defendant's position:

    (a) Whilst he states that the Fourth Defendant was operating over budget, the Fourth Defendant's balance sheet as at April 2020 showed indebtedness to the First Defendant of just in excess of £4.4 million (see page 66 of exhibit NJB1), the total anticipated investment, that is to say the sum of the acquisition costs and the estimated development costs set out at paragraph 11 above, was £6.6 million and cannot therefore be said that the projects were over budget.

    (b) The contention that the project was also over budget is inconsistent also with the email from Ms Harrison referred to at paragraph 14 above.

69. The First Defendant's conduct in failing to continue to fund the developments is therefore not justified on the grounds now asserted by him, namely a lack of confidence in the Claimant's ability to perform his side of the venture. Rather, it appears that the First Defendant saw an opportunity to make a profit for the benefit of himself, to the detriment of the Claimant and the Fourth Defendant, by ceasing funding of the venture and calling in his loans. The decision subsequently to sell two of the Properties to the

Second Defendant, a company controlled by the First Defendant, and to enter into a development agreement with the Second Defendant in respect of the third is indicative of this motivation.

70. The Claimant further criticises the First Defendant for failing to consider alternative sources of funding the developments to completion even if he were not willing to fund the projects himself. The Claimant asserts at paragraph 12 of his witness statement of 13 October 2020 that he has funding of £500,000 available immediately and, at paragraph 6 of his statement of 20 November 2020, he expresses confidence about raising the necessary finds to complete the developments through a broker.

71. Further, since this dispute has arisen, the First Defendant has acted contrary to the interests of the Fourth Defendant, but in his own interests by:

(a) Purporting to vote against a resolution to make an application to court for disclosure against the First Second and Third Defendants, notwithstanding the fact that it was plainly in the interests of the Fourth Defendant for such disclosure to occur.

(b) Causing the Fourth Defendant to incur liabilities without the authorisation of the board.

(c) Causing the Fourth Defendant to pay to him a VAT refund that it received from HMRC.

72. Taking the evidence together, the Claimant says that this is a classic case of a fraud on him where there is a deadlock in the company and the wrongdoer is stifling a claim that the Company would want to bring in its own name.

73. In respect of the claim against the Third Defendant, the Claimant contends that the evidence gives rise to considerable concern about how he approached the issue of selling the Properties:

(a) He did not obtain any valuations;

(b) The Properties were not marketed;

(c) The Third Defendant's analysis of the reasons for the sale, as set out in his witness statement dated 11 November 2020, indicates a concern about the indebtedness of the company. However, as a receiver appointed pursuant to the Law of Property Act, this was not a relevant consideration. The Claimant suggests that this may have led him to enter into error in his assessment of matters relevant to his equitable duty of care.

(d) He did not explore alternative options for the continued funding of the developments and/or realisation of the Fourth Defendant's assets with the Claimant, despite his being a director of the Fourth Defendant who, unlike the First Defendant, did not have a conflict of interest as the controlling mind of the proposed buyer (in the case of Tabley Court and Weaverham) and the proposed developer (in the case of Hob Hey Lane);

(e) He did not investigate whether the First Defendant's obvious conflict of interest had been disclosed to the Fourth Defendant.

74. The Claimant contends that, in light of the analysis in Lightman and Moss referred to above, the burden lies on the Third Defendant to show that his duties to the Fourth Defendant were discharged, yet he has not provided any proper basis to explain the decisions that the took.

75. The Claimant suggested at paragraph 42 of his skeleton argument that, because the claim against the Third Defendant is somewhat secondary to that against the First and Second Defendants, the court might consider it appropriate to defer determination of the case against him, pending determination of the claims against the First and Second Defendants. The wording of that paragraph appears to indicate a suggestion that the determination of the issue of permission to bring the derivative claim pursuant to Section 261 of the Companies Act be deferred, although in oral submissions, counsel for the Claimant limited his case to the suggestion that, assuming permission is given, the court's exercise of case management powers might sensibly defer the claim against the Third Defendant until after determination of the claim against the First and Second Defendants. I agree with the position taken by the Third Defendant that, the question of the granting permission having been brought to a head in this hearing, it should be resolved at this stage. The question of the proper case management of derivative claims (if they are allowed to proceed) is one properly dealt with following the filing of defences in the usual way.

76. Insofar as the Defendants allege that the Claimant has an alternative remedy, namely his own personal claim against the First Defendant pursuant to the alleged Joint Venture Agreement, the Claimant contends that this is not an adequate remedy. The primary purpose of the derivative claim is to recover the Fourth Defendant's assets, namely the Properties that have been transferred to the Second Defendant. It is far from clear that a claim by the Claimant himself against the Defendants would achieve the same end, having regard in particular to the principle in Foss v Harbottle and the rule against reflective loss.

A. Claims brought in reliance on the alleged breaches of duty owed by the First Defendant to the Claimant

77. The Claimant contends that the facts as set out support the existence of a duty on the part of the First Defendant to fund the development projects through to completion. Such a duty is at least arguable for the purpose of the permission application.

78. As to the existence of fiduciary duties, the Claimant acknowledges that this is a developing area of law, but, on the basis of the facts set out above and having regard to the judgment of Nugee J as he then was in Glenn v Watson [2018] EWHC 2016, there is an arguable case that the relationship between the Claimant and the First Defendant was one from which fiduciary duties might be found to be owed, given the dependence of the Claimant on the First Defendant continuing to invest in the projects if he was to be properly remunerated for his services. The Claimant draws parallels with the Pallant v Morgan equity that arises where parties enter into an endeavour where they agree to buy properties for development. This is factually a different situation, but one where it is arguable that equity will intervene to prevent one party taking advantage of the other.

79. As to the alleged duty of good faith, such a duty the Claimant contends, can readily be inferred from the relationship between himself and the First Defendant as joint venturers.

80. The Claimant goes on to contend that the Joint Venture Agreement was intended to confer a benefit on the Fourth Defendant, namely the continued funding of its properties. Accordingly, the duties owed by the First Defendant pursuant to that agreement are enforceable by the Fourth Defendant under the 1999 Act. The First Defendant's conduct amounts to a breach of those duties, hence the action should be permitted to proceed.

B. Claims brought in reliance on the alleged breaches of duty owed by the First Defendant to the Fourth Defendant

81. As regards these alleged breaches of duty, the Claimant relies upon the same facts as he relies on the claim arising from the First Defendants alleged breaches of duty. Although the duties are framed slightly differently and involve allegations of diverting business opportunities from the Fourth Defendant to the Second Defendant, in reality this is another part of the same course of conduct by which the Claimant contends that the First Defendant has turned the business of the joint venture to his own advantage.

C. Claims brought in reliance on the alleged breaches of duty owed by the Third Defendant to the Fourth Defendant

82. The duties relied on by the Claimant in respect of the claim against the Third Defendant are uncontroversial, though as I have noted there is some doubt as to where the burden of

proof lies in an allegation of sale at an undervalue where the sale is made by a receiver to an associate of a chargee.

83. As to the alleged breaches of duty by the Third Defendant, the Claimant makes the following points:

(a) The Court may readily draw the inference that the First Defendant interfered in the sale of the properties at Tabley Court and Weaverham and the entering into of the development contract in respect of Hob Hey Lane, given that the two properties were sold to his company within just 10 days of the appointment of the Third Defendant, without having been marketed, and the third was the subject of a development contract with his company. In those circumstances, the principle in Tse Kwong Lam applies and the burden lies on the Receiver (Third Defendant) and mortgagee (First Defendant) to show that the best price obtained on sale was the best price reasonably obtainable and/or that the terms of the development contract were the best reasonably obtainable.

(b) The Court has no satisfactory evidence to justify the price obtained. He did not obtain any valuation of the properties.

(c) The Third Defendant failed to engage with the Claimant prior to selling the two properties and entering into the development agreement in respect of the third.

(d) There is no evidence that the Third Defendant reflected upon the First Defendant's potential conflict of interest as being both a director of the Fourth Defendant and the owner of the Second Defendant.

84. Whilst of course the Third Defendant was not a director of the Fourth Defendant, the Claimant contends that the claim against him is sufficiently closely connected to that against the First Defendant as to bring it within the ambit of Section 260, since it "*arises from*" the conduct of the First Defendant in seeking to divert the Company's assets for his own benefit.

85. In so far as the Third Defendant seeks to place reliance upon clause 9 in the charges to exclude liability (which appears to be the position taken in his witness statement), the Claimant says that the clause is arguably not apt to cover the potential liability of the Third Defendant. However this point was not pursued in oral submissions. As the Claimant said, it is arguable that the clause is not wont to cover the situation here. For the purpose of a permission application, the court should treat with considerable caution the argument that the claim might be defeated by an exclusion clause such as this.

The First and Second Defendants' submissions

86. The Defendants rely on the First Defendant's account of his relationship with the Claimant and the circumstances of it breaking down. For the purpose of this application, the Defendants have to concede that there are triable issues as to what occurred, but they lay considerable emphasis on two overriding matters:

(a) A person exercising their duty under Section 172 of the 2006 Act would be alert to the fact that the litigation was likely to be heavily contested;

(b) The duties for which the Claimant contends inevitably involve asserting that the First Defendant was obliged to subordinate his own interests to those of the venture more generally. Having regard to the authorities cited above, a court is unlikely to impose duties that have this effect and therefore the prospects of success in the claim are poor.

A. Claims brought in reliance on the alleged breaches of duty owed by the First Defendant to the Claimant

87. The Defendants raise three general points of objection based upon the derivative claim of the Fourth Defendant arising from duties allegedly owed to the Claimant which it is contended may be enforced under the 1999 Act:

(a) The claims are contractual in nature, yet a derivative claim under the 2006 Act cannot be brought in respect of a contractual claim.

(b) The alleged breaches of contract are not claimed against the First Defendant in his capacity as director therefore the 2006 Act cannot be relied upon.

(c) The claims are based upon fiduciary not contractual duties therefore the 1999 Act does not apply.

88. On the first of these issues, the Defendants submit that the claims brought in reliance on the 1999 Act are, by definition, claims in contract. However, they submit that claims for breach of contract are not covered by Section 260(3) of the 2006 Act, since they are not claims "*arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust.*" Accordingly, the Defendants submit that a claim that arises by virtue of the 1999 Act cannot be the subject of a derivative claim under the Companies Act.

89. On the second issue, the Defendants draw attention to the fact that a claim under Section 260 of the 2006 Act can only be brought in respect of acts or omissions *"involving negligence, default, breach of duty or breach of trust <u>by a director of the company</u>"* (my

emphasis). From that starting point, the Defendants, as I follow the rather brief argument set out at paragraph 10 of their skeleton arguments and expanded on a little orally, contend that the court can only allow a derivative claim to proceed if it is brought against the director in his role of director of the company. This conclusion is said to flow from the decision in Customs and Excise Commissioners v Hedon Alpha Ltd cited above.

90. In any event, insofar as those claims rely upon fiduciary duties allegedly owed by the First Defendant to the Claimant, such duties are not *"terms of the contract"* such that the 1999 Act could allow them to be brought by the Fourth Defendant. In this regard, the Defendants rely upon a passage from the judgment of Lord Browne-Wilkinson in White v Jones [1995] 2 AC 207 at 271E, where he explains:

> "*The paradigms of the circumstances in which equity will find a fiduciary relationship is where one party, A, has assumed to act in relation to the property or affairs of another, B … By so assuming to act in B's affairs, A comes under fiduciary duties to B … The special relationship (i.e. a fiduciary relationship) giving rise to the assumption of responsibility … does not depend on any mutual dealing between A and B, let alone on any relationship akin to contract. Although such factors may be present, equity imposes the obligation because A has assumed to act in B's affairs. Thus, a trustee is under a duty of care to his beneficiary whether or not he has had any dealings with him…*"

91. The Defendants contend that, properly analysed, the duties relied upon by the Claimant in his claim against the First Defendant are fiduciary rather than contractual in nature. Accordingly, the 1999 Act has no application.

92. Turning to the duties themselves, as I have indicated, the Defendants divide the alleged breaches of duty into the following groups:

(a) an irrevocable obligation to fund the developments to completion;

(b) fiduciary duties;

(c) a duty of good faith;

93. The Defendants argue in respect of the first and third of these that the Claimant has no prospect of making out a breach of duty when the evidence is properly analysed. As to the second, the Defendants say they are simply not sustainable as a matter of law.

94. On the issue of the irrevocable contractual obligation to fund, the Defendants, draw attention to the following:

(a) The Particulars of Claim do not plead that the term of the funding was irrevocable;

(b) Clause 6.2 of the charges entered into in respect of the Properties states:

> "*at any time after this security has become enforceable or if at any time the property appears to the lender to be in danger of being taken in execution by any creditor of the mortgagor or to be otherwise in jeopardy, the lender may and without notice to the mortgagor:*
>
> *6.2.1 appoint any person to be a receiver of the property or any part of it, and*
>
> *6.2.2 remove any such receiver, whether or not appointing another in his place,*
>
> *and may at the time of appointment or at any time subsequently fix the remuneration of any receiver so appointed.*"

This, the Defendants say, is inconsistent with the First Defendant being under an irrevocable obligation to fund the development.

(c) The file note from Dootson's referred to at paragraph 9 above asserts that neither director was obliged to provide either capital or services. This is inconsistent with the alleged obligation on the First Defendant to fund the development of the Properties through to completion.

95. As to the argument that the First Defendant owed fiduciary duties to the Claimant, the Defendants draw attention to cases such as McKillen v Misland (Cyprus) Investments Limited and Al Nehayan v Kent cited above. There is nothing in the circumstances of this case to bring it within that unusual category where the court might find co-shareholders owe fiduciary duties to each other.

96. On the third category of claim, the duty of good faith, the Defendants concede the possibility that the First Defendant will be held to have owed such a duty to the Claimant. However, they contend that the ambit of such a duty is inevitably constrained by the circumstances. There were obviously potential conflicts of interest between the Claimant on the one hand and the First Defendant on the other. It would be exceptional to in effect imply into the joint venture agreement an obligation that the First Defendant had to subordinate his interests to those of the Claimant. As Sir William Blackburne put it in Myers v Kestrel Acquisitions [2015] EWHC 916 (Ch) at paragraph 63:

> "*where a commercial party... has a discretion which impinges directly on its own commercial and economic interests, exceptional circumstances are needed to imply*

a term requiring that party to subject those interests to those with whom it is dealing, not least when the incident in which the term is to be implied is one where, as here, the terms are to be found in a detailed and professionally prepared commercial document."

97. Given the breakdown in the relationship of the Claimant and the First Defendant there is no prospect of a court concluding that the First Defendant's conduct in ceasing to fund the venture and/or seeking repayment of his loan would, in the words of Leggatt LJ in Al Nehayan v Kent, *"be regarded as commercially unacceptable by reasonable and honest people."* Such a finding would amount to imposing an obligation on the First Defendant to subordinate his own interests to those of the Claimant.

B. Claims brought in reliance on the alleged breaches of duty owed by the First Defendant to the Fourth Defendant

98. As with the alleged breaches of duty owed by the First Defendant to the Claimant, the First Defendant contends that the case based upon the alleged breach of duties owed by him to the Fourth Defendant is unsustainable. Whilst the statutory duties pleaded in paragraph 47 of the Particulars of Claim are not in dispute (at least for the purpose of this application) and the Defendants do not take issue with the general proposition that the First Defendant owed to the Fourth Defendant a duty of loyalty, in order to succeed, the Claimant would have to prove that:

(a) The First Defendant was not entitled to demand repayment of loans, or at least acted in bad faith in doing so; and

(b) The First Defendant was not entitled to appoint a receiver, or at least acted in bad faith in doing so; and

(c) The receiver was not entitled to transfer the properties to the Second Defendant, or at least acted in bad faith in doing so.

99. However, as with the breach of duties alleged against the First Defendant, the Defendants contend that the relationship between the Claimant and the First Defendant (and of each of them with the Fourth Defendant), was such that it is not possible to either infer a duty of continuing funding or to categorise a failure to continue to fund as a breach of any statutory or other duty owed by the First Defendant to the Claimant. In this regard, the Defendants rely upon the same arguments as those set out above in respect of the duties allegedly owed to the Claimant. If one assumes that there was no irrevocable obligation to continue to fund the development, once the First Defendant had made the decision to

cease funding, he was entitled to conclude that the properties were in jeopardy, that he could call in his loan and that he could exercise the power to appoint a receiver.

100. But even if the Claimant proved the existence of such an irrevocable obligation and the requisite bad faith in the decision making, the Claimant would have to go on to prove that the transfer of the properties to the Second Defendant had caused loss to the Company. The Defendants say that such an argument is doomed to failure. In a skeleton argument dated 27 September 2020, prepared for the purpose of the hearing on 29 September 2020, counsel for the First Defendant analysed the potential valuation of the properties, comparing the sums actually received upon sale of Tabley Court and Weaverham with the Claimant's evidence as to the true value of those properties. Through that skeleton argument, he demonstrated that, even if those properties were sold at an undervalue, the true valuation relied upon by the Claimant would have left the position in which the Fourth Defendant's indebtedness to the First Defendant exceeded the value of the properties. The skeleton argument was prepared in support of the argument that the First Defendant was a creditor, or at least a contingent creditor, of the Fourth Defendant regardless of which valuations were relied upon. That was an argument that I accepted in considering the Administration application.

101. The Defendants now rely upon the same argument to show that, even if the transfer of the properties was at an undervalue and/or otherwise in bad faith, the Fourth Defendant is unable to show that it has suffered any loss as a result, at least absent any finding that the First Defendant was under an irrevocable duty to continue funding of the projects.

C. Claims brought in reliance on the alleged breaches of duty owed by the Third Defendant to the Fourth Defendant

102. In large part, the First and Second Defendants defer to the Third Defendant on the issue of the duties owed by him to the Fourth Defendant. However, the Second Defendant in particular has an interest in this aspect of the claim, since it is the transfer of two of the properties to it and the entering into of a development agreement with this in respect of the third property that underlies the claim against the Second Defendant.

103. Like the Third Defendant, the Second Defendant argues that there is no general prohibition on a receiver transferring properties to a company in which the mortgage or has an interest, subject to obtaining the best price reasonably obtainable. In any event, any loss to the Fourth Defendant as a result of such a transfer is limited to the extent to which the transfer was an undervalue which in any event is less than the Fourth Defendant's liability to the First Defendant and accordingly the proposed claim is of no value to the Fourth Defendant.

The Third Defendant's submissions

104. The Third Defendant's starting position in the material set out within his witness statement and summarised above is, in essence, that on his appointment, he was faced with a position where the Fourth Defendant was not able to continue to fund the development work that was taking place but that to suspend such work put the value of the Properties at risk. In those circumstances, it was appropriate for the Third Defendant to act quickly. In the Second Defendant, he had a willing buyer for Tabley Court and Weaverham whose offer did not appear unreasonable. By selling those two properties and entering into a development agreement with the Second Defendant in respect of Hob Hey Lane, he realised the two properties speedily and without further loss and secured the future of the third.

105. The Third Defendant understandably places particular emphasis on his independence from the First and Second Defendants and the broad margin of discretion and professional judgment allowed to receivers. On the evidence before the court, there is no prospect of a finding that the Third Defendant was clearly on the wrong side of that line.

Discussion

106. I shall consider first the Defendants' arguments that the various causes of action relied upon are, for a variety of reasons, unarguable. After that, I shall consider whether the derivative claim is one that a director acting in accordance with section 172 of the 2006 Act would not seek to continue, in which case the court has no jurisdiction as to whether to grant permission. If the Claimant clears this hurdle, it will be necessary to proceed to consider whether permission would in fact be granted having regard to all the circumstances of the case and, most particularly, the matters set out in section 263(3) of the 2006 Act.

A. Claims brought in reliance on the alleged breaches of duty owed by the First Defendant to the Claimant

107. The Defendant's argument that it is not open for a derivative action to be brought on the basis of duties owed by the First Defendant to the Claimant involves three propositions: first, that a derivative claim cannot be brought in respect of an alleged breach of contract, because section 260(3) of the 2006 Act does not allow this; second, that the claim here is based on the acts of the First Defendant as joint venturer rather than director and therefore cannot be the subject of a derivative claim; and, third, that the claims made by the Claimant are in any event not alleged breaches of contract but breaches of fiduciary duties and therefore any breach of such duties are not actionable by the suit of a third party under the 1999 Act.

108. Dealing with the first proposition, contrary to the Defendants' submission, a breach of contract is a breach of duty, the duty being one that arises under the contract. It is notable that Section 11 (1) of the Limitation Act 1980 speaks of the "*special time limit for actions in respect of personal injuries"* as applying "*to any action for damages for negligence, nuisance or breach of duty (whether the duty exists by virtue of a contract or of provision made by or under statute or independently of any contract or any such provision)…*" Whilst it might be thought that the express reference to a breach of duty including a duty existing by virtue of a contract is suggestive that, absent those words, the phrase would not be apt to include such a claim, it is in fact clear that these words are merely indicative of the breadth of the phrase "*breach of duty*". In Giles v Rhind [2008] EWCA 118, Arden LJ, as she then was, considered the phrase "*breach of duty"* in section 32 of the Limitation Act 1980 (which contains no such qualifying words) and said, at paragraph 40: "*as the judge said, the expression "breach of duty" most obviously connotes a breach of duty owed by the defendants to the claimant in the sense of a contractual, fiduciary or tortious duty*." (She went on to hold that the expression has a wider meaning, including a claim under section 423 of the Insolvency Act 1986, that is to say a claim arising from a transaction defrauding creditors.) In those circumstances, I have no hesitation in finding that the phrase "*breach of duty*" in the 2006 Act includes a breach of duty pursuant to a contract.

109. On the second issue, the argument was relatively undeveloped. For the purpose of this application, I am not persuaded that the point is well made. In Wallersteiner v Moir (No. 2) [1975] QB 373 at p. 390A, cited in Iesini, Lord Denning MR explained the justification for the right to bring a derivative action as follows:

> *"it is a fundamental principle of our law that a company is a legal person, with its own corporate identity, separate and distinct from the directors or shareholders, and with its own property rights and interests to which loan it is entitled. If it is defrauded by a wrongdoer, the company itself is the one person to sue for the damage. Such is the rule in Foss v Harbottle (1843) 2 Hare 461. The rule is easy enough to apply when the company is defrauded by outsiders. The company itself as the only person who can sue. Likewise, when it is defrauded by insiders of a minor kind, once again the company is the only person who can sue. But suppose it is defrauded by insiders who control its affairs – by directors who hold a majority of the shares – who then can sue for damages? Those directors are themselves the wrongdoers. If a board meeting is held, they will not authorise the proceedings to be taken by the company against themselves. The general meeting is called, they will vote down any suggestion that the company should sue them themselves. Yet the*

company is the one person who is damnified. It is the one person who should sue. In one way or another some means must be found for the company to sue."

110. In Iesini, Lewison J, having cited this passage from Lord Denning's judgment, went on:

> "*74. Lord Denning was clearly contemplating a case in which the companies cause of action was a cause of action against the "insiders" themselves who would be liable for damages. Indeed that seems to be the usual situation in which derivative actions were allowed to continue. That is why this exception to the rule in Foss v Harbottle (above) was often called a "fraud on the minority".*
>
> *75. A derivative claim, as these are defined by section 260(3) is not, however, confined to a claim against the insiders. As the concluding part of that subsection says, the cause of action may be against the director or another person (or both) nevertheless the cause of action must arise from* (emphasis in the original) *an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director* (again, emphasis in the original) *of the company. A derivative Claim may "only" be brought under Part 11 Ch 1 in respect of 1 cause of action having this characteristic…"*

111. There is nothing within the passages from either of these cases to limit the derivative claim to circumstances where the duty which the director is alleged to have breached arises other than from his role as director. Whilst derivative claims against directors will often involve allegations of breach of duties said to arise from that role, it is perfectly possible to conceive of circumstances in which a company has a potential claim against a director arising from acts or omissions which are not incidental to the person's role as director. Indeed, if the Claimant's case here is made out both in fact and in law, it is strongly arguable that the duties in respect of which the derivative claim is pursued do not arise from the First Defendant's role as director, but rather from his role as co-venturer with the Claimant. If the claim is otherwise maintainable by the company, is the Claimant to be prevented from pursuing a derivative claim against the First Defendant? To allow this would run counter to the justification for derivative actions enunciated by Lord Denning in Wallersteiner v Moir (No. 2). I am not satisfied that the right to bring a derivative claim is limited in the manner contended for by the Defendants.

112. As to the third issue, it is true that fiduciary duties often arise independently of contract. That however is not to say that similar duties cannot exist as an obligation in a contract. It is arguable that some or all of the duties alleged in paragraph 12 of the Particulars of Claim, if in fact contractual in nature, are not correctly described as "fiduciary duties". It is notable that, within their skeleton argument, the First and Second Defendants

distinguish between an obligation to fund to completion (see paragraphs 16 to 19) and other duties of a fiduciary nature (paragraphs 20 to 23).

113. In any event, I do not see that this argument is fatal to the current application. It would be a matter for the court in due course (if the Claimant is permitted to proceed) to consider the nature of any duties owed by the First Defendant and the extent to which the Fourth Defendant might be a beneficiary of those duties pursuant to the 1999 Act, but I do not see that this argument could defeat the claim at the permission stage, notwithstanding the duty to give consideration to the merits of the claim.

114. I turn then to the alleged duties relied upon by the Claimant, namely:

(a) an obligation to fund the developments to completion;

(b) fiduciary duties;

(c) a duty of good faith;

115. On the first of these issues, the Defendants characterise the duty contended for as an "irrevocable" duty to fund the developments to completion. However, as they themselves rightly point out, this is not precisely how it is pleaded in the Particulars of Claim. Rather the duty is said, at paragraph 8.2, to be one to "*provide the company with the capital to finance the acquisition of the properties identified by them for development and the development costs up to and in concluding completion of the agreed development.*" The Claimant then pleads:

(a) At paragraph 12(f), a fiduciary duty on the part of the First Defendant "to fulfil his obligation under the Joint Venture Agreement to provide the Company with adequate capital to develop out the properties he chose to acquire."

(b) At paragraph 13(a), a duty to act in good faith towards the Claimant and/or the company in his dealings relating to the Joint Venture Agreement;

(c) At paragraph 13(b), a duty not to exercise any of his powers as fundholder, charge holder or otherwise "*contrary to the spirit and/or objectives of the Joint Venture Agreement and/or in such a manner as to favour himself to the disadvantage*" of the Fourth Defendant and/or Claimant.

116. It is a striking feature of the Joint Venture Agreement that, on either party's case, the Claimant's profit from the developments was entirely (based on the First Defendant's case that he had no entitlement to remuneration other than a payment on account of profits) or substantially (on the Claimant's case that he had a right to remuneration of £50,000 per annum) dependent upon the development of the Property being seen through

to completion. In that sense, the Claimant was very dependent upon the First Defendant's willingness to provide funding. In light of this, it is not fanciful to argue that the First Defendant's right to bring the relationship to an end was qualified at the very least by a duty to act in good faith, if not by a limitation on his right to withdraw further funding. I have considerable doubt that a court would conclude that the relationship was such that the First Defendant was obliged to put the Claimant's interests ahead of his and it follows that I doubt that he will be held to have owed fiduciary duties. But some lesser level of duty, in particular a duty to act in good faith, is, as I say, not far-fetched.

117. Further, given that the Claimant's benefit from this project (in whole or in large part) depended upon the success of the Fourth Defendant, it is in my judgment possible to see how the court would conclude that the Joint Venture Agreement purported to confer a benefit on it and that therefore it may in its own right enforce terms of the contract pursuant to the 1999 Act.

B. Claims brought in reliance on the alleged breaches of duty owed by the First Defendant to the Fourth Defendant

118. Again, the first consideration in respect of these claims is whether the Claimant shows an arguable case that the First Defendant breached the duties allegedly owed to the Fourth Defendant.

119. As to whether the Fourth Defendant is unable to show that it has suffered any loss as a result of the sale of Tabley Court and/or Weaverham, the Defendants argue, correctly in my view, that the evidence available to the court indicates that, on the Claimant's best case, if the transfer of the properties were set aside and they were returned to the ownership of the Fourth Defendant and/or if the Fourth Defendant recovered damages to reflect any loss caused by sale at an undervalue, it would remain the case that its indebtedness to the First Defendant exceeded its assets. That is a significant factor to bear in mind in considering the exercise of the power to grant permission.

120. However, if that remedy were coupled with a claim for damages for the failure of the First Defendant to fund the development through to completion, it is not inevitable that the indebtedness would exceed the assets. It is inherent to profiting from property development that the developer achieves a sale for more than the current cost of the property together with the development costs. If the two properties were to be returned to the Fourth Defendant then, with appropriate funding, whether by way of the damages claim against the First Defendant or otherwise, it is possible that the Fourth Defendant would achieve a position where the value of the Properties exceeded the indebtedness to

the First Defendant, though the figures set out by the Defendants indicate that such an argument would not be easy to maintain.

121. The way the First and Second Defendants put the argument is that, unless the Claimant shows a strong claim that the First Defendant was in breach of duty to the Company to provide funding (or assist in the procurement of alternative funding, which funding would have been obtained and is now no longer available) the court should refuse permission under Section 263 because the Company has suffered no loss. Whilst there is force in this argument, I do not accept that the Claimant has to show a 'strong' claim that the First Defendant was in breach of such a duty – it would be sufficient for the Claimant to show an arguable claim in order to bring the case within the category in which the court can exercise the discretion contained in Section 263, in which case the strength of that case would be one of the factors to be taken into account in the exercise of the discretion.

122. For reasons that I have identified in respect of the claim based upon the alleged breach of duties owed by the First Defendant to the Claimant, it is possible that the First Defendant will be found in breach of the duty of good faith in failing to complete the funding of the developments. If such an argument were to succeed, then, as the First and Second Defendants concede in their skeleton argument, the Claimant may be able to show that the Fourth Defendant's assets exceed the indebtedness to the First Defendant.

C. Claims brought in reliance on the alleged breaches of duty owed by the Third Defendant to the Fourth Defendant

123. I have set out above the arguments advanced by the Claimant in respect of the alleged breach of duty on the part of the Third Defendant. The circumstances of the sale of Tabley Court and Weaverham may give rise to a suspicion as to whether the Third Defendant discharged his duties as receiver. Such a case is not doomed to failure, in particular given the relatively sparse explanation given by the Third Defendant thus far for his actions, although the hypothetical director considering such a case under Section 172 would have firmly in mind the evidence that the Third Defendant has no previous connection with the First Defendant.

124. An assessment of the prospects of the case against the Third Defendant involves considering whether the court would draw an adverse inference against him, absent a full explanation for his decision-making. The judgment of HHJ Paul Matthews in Devon Commercial Property raises an interesting question as to whether the authors of Lightwood and Moss correctly state the burden of proof in the context of a claim against a receiver for alleged sale at an undervalue to an associate of a chargee. Whereas, as a

matter of principle, Judge Matthews' comments about the distinction to be drawn between the role of the receiver and that of the mortgagor at paragraph 28 of the judgment is surely correct, the practical difficulty in this scenario lies in the fact that a close relationship between receiver and mortgagee may allow impropriety to go undiscovered. That risk might be thought to justify the application of a "fair dealing rule", which after all is only rule of evidence, in such circumstances.

125. For the purpose of this application, that argument is academic. I am not engaged in a fact-finding exercise. I am however entitled to look at the quality of evidence adduced thus far in determining whether to grant permission for the derivative action to proceed. Where the receiver in the position of the Third Defendant is able to give a full and persuasive explanation as to the circumstances of the sale, that is likely to weigh heavily against allowing permission to bring a derivative action on the ground claim is unlikely to succeed, whereas if there is little detail forthcoming, the court is likely to be more readily persuaded that the claim is arguable and should go forward to trial.

Would a person acting in accordance with section 172 (duty to promote the success of the company) not seek to continue the claim?

126. Whereas the other statutory considerations set out below go to the discretion as to whether to grant permission, this first matter of course goes to jurisdiction. If a person acting in accordance with section 172 would not seek to continue the claim, the court has no power to grant permission for the claim to proceed.

127. If this were a hopeless claim, then even in circumstances in which the person seeking to bring the derivative claim agrees to fund the action and to indemnify the company, it would be difficult to see that any hypothetical director acting in accordance with her or his duty under Section 172 would consider that the claim ought to be pursued, since the hypothetical director would reason that any potential loss of reputation through pursuing the claim would inevitably outweigh the potential benefit of pursuing the claim, since there would be none.

128. However, having rejected the Defendants' argument that the claim against the First and/or Second Defendants has no prospects of success because it cannot be brought within the ambit of section 260 of the 2006 Act and/or Section 1 of the 1999 Act, and having concluded that the causes of action alleged are not unarguable, the court is left with assessing the prospects of success of the claim which, on one view of the facts, could succeed on at least some of the causes of action pleaded. If successful, the potential benefit to the company would or at least could outweigh any possible reputational damage, given the Claimant's position on costs. In those circumstances, the hypothetical

director might choose to pursue the derivative claim and the court is therefore not bound to refuse the application under Section 263(2) of the 2006 Act.

129. Equally, notwithstanding all of the difficulties in pursuing a claim against a receiver (who for good reasons is given a wide margin of discretion in the discharge of his or her duties), the claim against the Third Defendant is not to my mind so hopeless that a director, exercising their duties under Section 172, would reject out of hand a proposal to proceed with a claim against the receiver that might benefit the company in circumstances in which that litigation was being underwritten by a third party.

Is the Claimant acting in good faith in seeking to continue the claim?

130. The Defendants contend that the Claimant's account of his dealings with the First Defendant is a misrepresentation of the true position. To that extent, they allege that he is not acting in good faith. Further, the Third Defendant contends that this claim arises from the failed discussions between the Claimant and the First Defendant in respect of a buy out following their falling out. The Third Defendant submits that "*it is an obvious inference that any fair-minded observer would draw that these claims are brought not for the benefit of the Company itself but to improve Mr Hughes' position in his negotiation with Mr Burley. This is an obvious inference because (1) any recovery by the Company would merely serve to make it less insolvent than it already is; (2) it would increase the Company's assets only to the benefit of Mr Burley as its main creditor. It is not suggested that Mr Hughes does not make the application honestly (although it is noted that there are keen disputes of fact between him and Mr Burley) but it is suggested that the true purpose of the claims is not in reality to benefit the Company but to improve Mr Hughes' negotiating position in his dispute with Mr Burley*" (paragraph 65 of the Third Defendant's skeleton argument).

131. However, whilst the Defendants allege that the Claimant has remedies available to him (as of course is reflected in his bringing the claim in his own name as well as pursuant to Section 260), it is not suggested that through bringing a derivative claim as well as a personal claim, the Claimant seeks some unfair advantage that demonstrates bad faith on his part.

132. In any event, whilst the Third Defendant is undoubtedly right to say that the derivative claim is brought for the ultimate benefit of its members (specifically the Claimant), the route through which the claimant seeks that benefit is the assertion that the Fourth Defendant should have been given and should now be given the opportunity to complete the development of the properties. This raises the very issue of reflective loss that causes the Claimant to argue that a derivative claim is justified in the first place. It is arguable

that the only basis upon which this claim can succeed is one where the Claimant shows that, but for breaches of duty by the Defendants, the Fourth Defendant would have successfully developed the Properties and would have assets that exceeded its liabilities to the First Defendant. Such a claim could probably only be brought by the Fourth Defendant.

What importance would a person acting in accordance with Section 172 attach to continuing the claim?

133. A person acting in accordance with Section 172 would have regard in particular to the following matters:

(a) The claim involves significant factual and legal disputes. In particular

i. It is difficult to see how the claim against the First Defendant can succeed without showing some duty on his part in respect of the continued funding of the projects. Such a continuing duty to fund the development, with the concomitant implication that the First Defendant might have to prefer the interests of the Claimant to his own, is likely to be difficult to substantiate.

ii. It is likely to prove difficult to show that the Third Defendant's actions were "*plainly on the wrong side of the line.*"

(b) Litigation of this kind is likely to be lengthy and expensive.

(c) On the face of it, the litigation will be conducted at no financial risk to the Company because it is to be funded by the Claimant. However, as the Third Defendant rightly points out, there is no evidence before the court as to the Claimant's ability to fund the claim. A hypothetical director observing this would be concerned that an unsuccessful claim against the Defendants would further reduce the available assets to pay the Company's creditors (specifically the First Defendant). The director would expect to see evidence to support the Claimant's ability to fund what is likely to be expensive litigation, yet none is forthcoming.

(d) The litigation will impose no burden on the operation of the Company or its employees because the company is largely dormant (having disposed of two of the Properties and entered into a development agreement with the Second Defendant in respect of the third), and no resources of the company would be consumed in the litigation.

(e) If the litigation were to be unsuccessful, this might in theory adversely affect the company's reputation. However, in reality, if the litigation is unsuccessful, it

appears inevitable that the company will be wound up without further trading, in which case no reputational damage would be caused.

(f) If the litigation were to be successful, it might take the Company from a position of being insolvent to one of being solvent. However, even if the claim were in part successful, as the Defendants have shown, the victory may be Pyrrhic since it may not alter the fact that the Company's assets are less than its indebtedness to the First Defendant.

(g) The litigation arises in circumstances where there is a bitter dispute between the two equal shareholders in the company. It is arguably unfair to either of them, but the company is prevented from taking action against the other by reason of the fact that there is no mechanism to deal with the stalemate that arises when they disagree.

(h) On the other hand, litigation conducted in a derivative claim by one of those warring shareholders against the other is unlikely to be scrutinised in the same way that such litigation would be were it carried out by an independent scrutiny through the route of liquidation.

Where the cause of action results from an act or omissions that is yet to occur, could the act or omission be, and in the circumstances would it be likely to be, (i) authorised by the company before it occurs or (ii) ratified by the company after it occurs?

134. The cause of action arises from acts that have already occurred. Accordingly this consideration is not relevant.

Where the cause of action arises from an act or omission that has already occurred, could the act or omission be, and in the circumstances would it be likely to be, ratified by the company?

135. As indicated, the cause of action arises from the breakdown in relations between the Claimant and the First Defendant who are equal shareholders. Given that there is no mechanism to break the stalemate that results from them having opposing views as to how the Fourth Defendant should act, there is no prospect of the company ratifying the alleged acts or omissions.

Has the company decided not to pursue the claim?

136. The company has made no decision on whether to pursue the claim. Again, this is a consequence of the dispute between the Claimant and the First Defendant.

Does the act or omission in respect of which the claim is brought give rise to a cause of action that the Claimant could pursue in his own right rather than on behalf of the company?

137. The Claimant has himself brought a claim arising out of the same facts as those in respect of which the derivative claim is brought. Whilst that claim too is denied, the establishment of a cause of action on the Claimant's part is probably more straightforward than the derivative claim, in that it does not involve the court having to deal with the intricacies of the 1999 Act (as to whether a third party can bring a claim on the Joint Venture Agreement) or the 2006 Act (as to what types of claim can be brought by way of derivative action). However, the Claimant has maintained throughout this litigation that, having regard to the rule in Foss v Harbottle and the principle against reflective loss, it is by no means clear that the Claimant's loss (if any) as a result of any breach of duty on the part of the Defendants would equal the losses that the Fourth Defendant could claim.

Is there any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter?

138. Since the Claimant and the First Defendant are the sole shareholders in the company, there is no disinterested member of the Company whose views could be canvassed.

Conclusion

139. This claim is speculative in nature, dependent upon the favourable resolution of factual issues, as well as the court being invited to make findings that lie at the outer edges of the current thinking on the nature of the duties of joint venturers. Causes of action alleged are not unarguable for the reasons identified above, but it is likely that this litigation would be drawn out and expensive. In the context of a company which is insolvent and unable to meet its full liability to its major creditor, the First Defendant, a person having regard to their duty under section 172 of the 2006 Act would undoubtedly pause long and hard before deciding to proceed with the litigation.

140. Furthermore, were the Company to be in a position which was likely to continue to trade regardless of the outcome of the litigation, the hypothetical director would have significant concerns about the reputational damage that defeat in litigation might bring. In the event however, I am satisfied that, unless this litigation were successful, the Company is unlikely to resume trading and therefore any reputational damage is no more than theoretical.

141. Were I to be persuaded that the Claimant has the means to fund the litigation to conclusion, including the means to meet any adverse costs order that may be made, as well as showing that he has an irrevocable liability to meet any costs order that might be

made against the Fourth Defendant, that would be a significant factor in favour of granting permission. In those circumstances, the hypothetical director might consider that, in the absence of any factors weighing against pursuing the litigation, it was appropriate to let the claim proceed by way of third party funding and indemnity, since the company had nothing to lose.

142. The Claimant has however adduced no evidence as to his means to fund the litigation. Further, he has not proffered any undertaking in respect of indemnifying the Fourth Defendant against any costs liability that might arise. On the second issue, the hypothetical director having regard to their duties under section 172 might have taken the view that it was appropriate to permit the litigation to continue on condition that such an undertaking was forthcoming (a requirement that I could impose as a condition of granting permission under section 261 of the 2006 Act). But the absence of evidence on the first issue would leave the hypothetical director in a position which they could have no confidence as to the value of any such undertaking.

143. In those circumstances, I am not persuaded that it is proper to give permission for this derivative claim to proceed. It would leave the Fourth Defendant at risk of further harm to its interests.

144. In the light of my previous findings, it appears that it is now appropriate to make an Administration Order in respect of the Fourth Defendant. However, I invite the parties to discuss the appropriate order consequent upon this judgment and will if necessary hear the parties further on the issue of consequential orders.

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in accordance with the policy that I take to be underlying that procedure, as well as the modern policy of the courts towards plaintiffs who are guilty of delay. Accordingly, I allow the appeal from the master's decision, and dismiss the originating summons. A

Order accordingly.

Solicitors: Holman Fenwick & Willan; Thomas Cooper & Stibbard. B

[Reported by IAN SAXTON, ESQ., Barrister-at-Law]

C

SMITH AND OTHERS v. CROFT AND OTHERS (No. 2) D

[1985 S. No. 637]

1986 Oct. 29, 30, 31;
Nov. 3, 4, 5, 6, 7, 10, 11, 13, 14, 17, 18, 19, 20, 21;
Dec. 19

Knox J. E

Company—Shareholder—Rights against company or directors—Minority shareholders' action—Minority shareholders alleging ultra vires acts by company and directors—Majority of independent minority shareholders not wishing to pursue action—Whether minority shareholders' action to be struck out—Whether striking out procedure appropriate—R.S.C., Ord. 18, r. 19

F

F. Ltd. was a company engaged in the specialised business of guaranteeing the completion of films on time and within their budget. The articles of association provided that a director should be remunerated for his services at the rate of £150 per annum, the chairman receiving an additional £100 per annum, but the rate of remuneration could be increased by an ordinary resolution. The directors were also empowered to appoint one or more of their number to be holders of an executive office, and any director appointed to such office was to receive such additional remuneration by way of salary, lump sum, commission or participation in profits as the directors might determine. During the course of 1982 the appointed executive directors and companies with which they were associated acquired sufficient shares in F. Ltd. to give them overall voting control. The shares were bought by means of payments made to three of the associated companies in August 1982 of £33,000 each, part of which was then lent to the fourth to discharge a bank loan taken out for the purpose of obtaining cash to buy shares in F. Ltd. and the remainder was used for the purchase of shares by G H

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A the three associated companies. The plaintiffs, who held a minority of shares in F. Ltd., brought an action against F. Ltd., three executive directors and the chairman, a non-executive director, and four companies closely associated with one or other of the three executive directors, claiming that the directors had paid themselves excessive remuneration, that the payments in 1982 to the associated companies were contrary to section 42 of the Companies Act 1981[1] and that certain payments of B expenses to directors were excessive. The plaintiffs between them held 11·86 per cent. of the issued shares in F. Ltd.; the defendants between them held 62·54 per cent.; of the remaining shares 2·54 per cent. were held by a company which actively supported the plaintiffs, while 3·22 per cent. were held by persons or companies which, it was common ground, were to be treated as supporting the defendants. W. Ltd., a company not C under the control of either the plaintiffs or the defendants, held 19·66 per cent. of the shares in F. Ltd. and was opposed to the continuance of the plaintiffs' action.

On a motion by the chairman and F. Ltd. to strike out the plaintiffs' action under R.S.C., Ord. 18, r. 19 or under the inherent jurisdiction as vexatious, frivolous or an abuse of process:—

Held, (1) that the defendants' application raised the issue D whether the plaintiffs could proceed with their minority shareholders' action and, although that raised difficult questions of law, the defendants, by invoking the procedure under R.S.C., Ord. 18, r. 9 rather than the procedure for determining a preliminary issue of law under R.S.C., Ord. 33, r. 3, had not adopted such an inherently defective procedure that the court should not proceed to determine the issues raised; and that E since the effect of the court deciding those issues against the plaintiffs would be determinative of the action, the court would entertain the application and consider whether prima facie the company was entitled to the relief claimed in the action and whether the action was within the exception to the rule in *Foss v. Harbottle* (post, pp. 135B–C, E–G, 138G—139B, 145C–F).

Prudential Assurance Co. Ltd. v. *Newman Industries Ltd. (No. 2)* [1982] Ch. 204, C.A. and *Williams and Humbert Ltd. v.* F *W. &. H. Trade Marks (Jersey) Ltd.* [1986] A.C. 368, H.L.(E.) considered.

(2) That although excessive remuneration paid to directors might be an abuse of power, where the power to decide remuneration was vested in the board, it could not be ultra vires the company; and that in view of the uncontradicted evidence about the specialised field in which the company G operated and the high levels of remuneration obtaining there it was more likely that the plaintiffs would fail than succeed on the issue of quantum; that likewise no prima facie case had been shown that the executive directors' expenses were excessive; and that, prima facie, the payments to associated companies were not ultra vires since payments at the request of an executive director to an outside entity were capable of being payments in respect of services rendered by the executive H director, save that there was a prima facie case of irregularity regarding certain payments not fully cured by subsequent adoption of the accounts at the annual general meetings at

[1] Companies Act 1981, s. 42: see post, p. 164B–D.

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which those payments should have been disclosed; that since the admitted payments of £33,000 to associated companies had not been shown to be reasonably necessary for the purpose of providing for amounts likely to be incurred by way of directors' remuneration there was a prima facie case of infringement of section 42 of the Companies Act 1981 (post, pp. 159F—160D, 163C—164A, 165C—166A).

In re George Newman & Co. [1895] 1 Ch. 674, C.A. and *Rolled Steel Products (Holdings) Ltd. v. British Steel Corporation* [1986] Ch. 246, C.A. applied.

(3) That although a minority shareholder had locus standi to bring an action on behalf of a company to recover property or money transferred or paid away in an ultra vires transaction, he did not have an indefeasible right to prosecute such an action on the company's behalf; that it was proper to have regard to the views of the independent shareholders, and their votes should be disregarded only if the court was satisfied that they would be cast in favour of the defendant directors in order to support them rather than for the benefit of the company, or if there was a substantial risk of that happening; that there was no evidence to suggest that the votes of W. Ltd. would be cast otherwise than for reasons genuinely thought to be for the company's advantage; and that, accordingly, since the majority of the independent shareholders' votes, including those of W. Ltd., would be cast against allowing the action to proceed, the statement of claim should be struck out (post, pp. 170A–D, 177B–C, 186E–F, 189C–E).

Foss v. Harbottle (1843) 2 Hare 461 considered.

The following cases are referred to in the judgment of 13 November ruling that the defendants could proceed with their application to strike out:

Foss v. Harbottle (1843) 2 Hare 461
Lawrance v. Lord Norreys (1890) 15 App.Cas. 210, H.L.(E.)
Prudential Assurance Co. Ltd. v. Newman Industries Ltd. [1981] Ch. 229; [1980] 2 W.L.R. 339; [1979] 3 All E.R. 507
Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2) [1982] Ch. 204; [1982] 2 W.L.R. 31; [1982] 1 All E.R. 354, C.A.
Smith v. Croft [1986] 1 W.L.R. 580; [1986] 2 All E.R. 551
Wallersteiner v. Moir (No. 2) [1975] Q.B. 373; [1975] 2 W.L.R. 389; [1975] 1 All E.R. 849, C.A.
Wenlock v. Moloney [1965] 1 W.L.R. 1238; [1965] 2 All E.R. 871, C.A.
Williams and Humbert Ltd. v. W. & H. Trade Marks (Jersey) Ltd. [1986] A.C. 368; [1986] 2 W.L.R. 24; [1986] 1 All E.R. 129, H.L.(E.)
Windsor Refrigerator Co. Ltd. v. Branch Nominees Ltd. [1961] Ch. 375; [1961] 2 W.L.R. 196; [1961] 1 All E.R. 277, C.A.

The following additional cases were cited in argument on the question whether the defendants should be permitted to proceed with their application:

Bagshaw v. Eastern Union Railway Co. (1849) 7 Hare 114
Carter v. Commissioner of Police of the Metropolis [1975] 1 W.L.R. 507; [1975] 2 All E.R. 33, C.A.
City of London Corporation v. Horner (1914) 111 L.T. 512, C.A.
Daniels v. Daniels [1978] Ch. 406; [1978] 2 W.L.R. 73; [1978] 2 All E.R. 89
Electrical Development Co. of Ontario v. Attorney-General for Ontario [1919] A.C. 687, P.C.

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A *Estmanco (Kilner House) Ltd. v. Greater London Council* [1982] 1 W.L.R. 2; [1982] 1 All E.R. 437
Goodson v. Grierson [1908] 1 K.B. 761, C.A.
Isaacs (M) and Sons Ltd. v. Cook [1925] 2 K.B. 391
Morris v. Sanders Universal Products [1954] 1 W.L.R. 67; [1954] 1 All E.R. 47, C.A.
National Real Estate and Finance Co. Ltd. v. Hassan [1939] 2 K.B. 61; [1939] 2 All E.R. 154, C.A.
B *Nissan v. Attorney-General* [1970] A.C. 179; [1969] 2 W.L.R. 926; [1969] 1 All E.R. 629, H.L.(E.)
Radstock Co-operative and Industrial Society Ltd. v. Norton-Radstock Urban District Council [1968] Ch. 605; [1968] 2 W.L.R. 1214; [1968] 2 All E.R. 59, C.A.
Richards v. Naum [1967] 1 Q.B. 620; [1966] 3 W.L.R. 1113; [1966] 3 All E.R. 812, C.A.
C *Rolled Steel Products (Holdings) Ltd. v. British Steel Corporation* [1986] Ch. 246; [1985] 2 W.L.R. 908; [1985] 3 All E.R. 52, C.A.
Russell v. Wakefield Waterworks Co. (1875) L.R. 20 Eq. 474
Salomons v. Laing (1850) 12 Beav. 377
Tilling v. Whiteman [1980] A.C. 1; [1979] 2 W.L.R. 401; [1979] 1 All E.R. 737, H.L.(E.)
D *Western Steamship Co. Ltd. v. Amaral Sutherland & Co. Ltd.* [1914] 3 K.B. 55, C.A.

The following cases are referred to in the judgment of 19 December:

Allen v. Gold Reefs of West Africa Ltd. [1900] 1 Ch. 656, C.A.
Bagshaw v. Eastern Union Railway Co. (1849) 7 Hare 114
Baillie v. Oriental Telephone and Electric Co. Ltd. [1915] 1 Ch. 503, C.A.
E *Bamford v. Bamford* [1970] Ch. 212; [1969] 2 W.L.R. 1107; [1969] 1 All E.R. 969, C.A.
Birch v. Sullivan [1957] 1 W.L.R. 1247; [1958] 1 All E.R. 56
Brown v. British Abrasive Wheel Co. Ltd. [1919] 1 Ch. 290
Burland v. Earle [1902] A.C. 83, P.C.
Clinch v. Financial Corporation (1868) L.R. 5 Eq. 450; L.R. 4 Ch.App. 117
Daniels v. Daniels [1978] Ch. 406; [1978] 2 W.L.R. 73; [1978] 2 All E.R. 89
Edwards v. Halliwell [1950] 2 All E.R. 1064, C.A.
F *Estmanco (Kilner House) Ltd. v. Greater London Council* [1982] 1 W.L.R. 2; [1982] 1 All E.R. 437
Foss v. Harbottle (1843) 2 Hare 461
Gray v. Lewis (1873) L.R. 8 Ch.App. 1035
Halt Garage (1964) Ltd., In re [1982] 3 All E.R. 1016
Hellenic & General Trust Ltd., In re [1976] 1 W.L.R. 123; [1975] 3 All E.R. 382
G *Hogg v. Cramphorn Ltd.* [1967] Ch. 254; [1966] 3 W.L.R. 995; [1966] 3 All E.R. 420
MacDougall v. Gardiner (1875) 1 Ch.D. 13, C.A.
Mason v. Harris (1879) 11 Ch.D. 97, Malins V.-C. and C.A.
Mozley v. Alston (1847) 1 Ph. 790
Newman (George) & Co., In re [1895] 1 Ch. 674, C.A.
Pavlides v. Jensen [1956] Ch. 565; [1956] 3 W.L.R. 224; [1956] 2 All E.R. 518
H *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204; [1982] 2 W.L.R. 31; [1982] 1 All E.R. 354, C.A.
Rolled Steel Products (Holdings) Ltd. v. British Steel Corporation [1986] Ch. 246; [1985] 2 W.L.R. 908; [1985] 3 All E.R. 52, C.A.

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Russell v. Wakefield Waterworks Co. (1875) L.R. 20 Eq. 474 A
Salomons v. Laing (1850) 12 Beav. 377
Seaton v. Grant (1867) L.R. 2 Ch.App. 459
Sidebottom v. Kershaw, Leese & Co. Ltd. [1920] 1 Ch. 154, C.A.
Simpson v. Westminster Palace Hotel Co. (1860) 8 H.L.Cas. 712, H.L.(E.)
Smith v. Croft [1986] 1 W.L.R. 580; [1986] 2 All E.R. 551
Taylor v. National Union of Mineworkers (Derbyshire Area) [1985] B.C.L.C. 237 B
Towers v. African Tug Co. [1904] 1 Ch. 558, C.A.
Viscount of the Royal Court of Jersey v. Shelton [1986] 1 W.L.R. 985, P.C.
Wallersteiner v. Moir (No. 2) [1975] Q.B. 373; [1975] 2 W.L.R. 389; [1975] 1 All E.R. 849, C.A.

The following additional cases were cited in argument; some of them being cited before the judgment of 13 November was delivered: C

Atwool v. Merryweather (1867) L.R. 5 Eq. 464n
Australian Coal & Shale Employees' Federation v. Smith (1937) 38 S.R.(N.S.W.) 48
Banco de Bilbao v. Sancha [1938] 2 K.B. 176
Burt v. British Nation Life Assurance Association (1859) 4 De G. & J. 158
Clemens v. Clemens Bros. Ltd. [1976] 2 All E.R. 268
Cook v. Deeks [1916] 1 A.C. 554, P.C. D
Cotter v. National Union of Seamen [1929] 2 Ch. 58, C.A.
Cullerne v. London and Suburban General Permanent Building Society (1890) 25 Q.B.D. 485, C.A.
Davidson v. Tulloch (1860) 3 Macq. 783, H.L.(Sc.)
Devlin v. Slough Estates Ltd. [1983] B.C.L.C. 497
Dominion Cotton Mills Co. Ltd. v. Amyot [1912] A.C. 546, P.C.
Duomatic Ltd., In re [1969] 2 Ch. 365
Electrical Development Co. of Ontario v. Attorney-General for Ontario [1919] A.C. 687, P.C. E
Gray v. Lewis (1869) L.R. 8 Eq. 526
Greenhalgh v. Arderne Cinemas Ltd. [1951] Ch. 286; [1950] 2 All E.R. 1120, C.A.
Gregory v. Patchett (1864) 33 Beav. 595
Heyting v. Dupont [1963] 1 W.L.R. 1192; [1963] 3 All E.R. 97; [1964] 1 W.L.R. 843; [1964] 2 All E.R. 273, C.A. F
Hichens v. Congreve (1828) 4 Russ. 562
Hoole v. Great Western Railway Co. (1867) L.R. 3 Ch.App. 262
Horsley & Weight Ltd., In re [1982] Ch. 442; [1982] 3 W.L.R. 431; [1982] 3 All E.R. 1045, C.A.
Lee, Behrens & Co. Ltd., In re [1932] 2 Ch. 46
Lord v. Governor and Company of Copper Miners (1848) 2 Ph. 740
MacDougall v. Gardiner (1875) L.R. 20 Eq. 383 G
Menier v. Hooper's Telegraph Works (1874) L.R. 9 Ch.App. 350
Multinational Gas and Petrochemical Co. v. Multinational Gas and Petrochemical Services Ltd. [1983] Ch. 258; [1983] 3 W.L.R. 492; [1983] 2 All E.R. 563, C.A.
North-West Transportation Co. Ltd. v. Beatty (1887) 12 App.Cas. 589, H.L.(E.)
Orr v. Glasgow, Airdrie and Monklands Junction Railway Co. (1860) 3 Macq. 799 H
Peel v. London and North Western Railway Co. [1907] 1 Ch. 5, C.A.
Pender v. Lushington (1877) 12 App.Cas. 70
Pickering v. Stephenson (1872) L.R. 14 Eq. 322

A *Prudential Assurance Co. Ltd. v. Newman Industries Ltd.* [1981] Ch. 229; [1980] 2 W.L.R. 339; [1979] 3 All E.R. 507
Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2) [1981] Ch. 257; [1980] 2 W.L.R. 339; [1979] 3 All E.R. 507
Radstock Co-operative and Industrial Society Ltd. v. Norton-Radstock Urban District Council [1968] Ch. 605; [1968] 2 W.L.R. 1214; [1968] 2 All E.R. 59, C.A.
B *Richards v. Naum* [1967] 1 Q.B. 620; [1966] 3 W.L.R. 1113; [1966] 3 All E.R. 812, C.A.
Russian Commercial and Industrial Bank v. Comptoir D'Escompte de Mulhouse [1925] A.C. 112, H.L.(E.)
Shuttleworth v. Cox Brothers & Co. (Maidenhead) Ltd. [1927] 2 K.B. 9, C.A.
Sinclair v. Brougham [1914] A.C. 398, H.L.(E.)
C *Smith & Fawcett Ltd., In re* [1942] Ch. 304; [1942] 1 All E.R. 542, C.A.
Spokes v. Grosvenor and West End Railway Terminus Hotel Co. Ltd. [1897] 2 Q.B. 124, C.A.
Studdert v. Grosvenor (1886) 33 Ch.D. 528
Turquand v. Marshall (1869) L.R. 4 Ch.App. 376
Wall v. London and Northern Assets Corporation [1898] 2 Ch. 469, C.A.
Yorkshire Miners' Association v. Howden [1905] A.C. 256, H.L.(E.)

D

MOTIONS

By a writ dated 7 February 1985, the plaintiffs, Nora Smith, Lucienne Crane, and the Right Honourable Felim O'Neill, Baron Rathcavan, in a specially endorsed writ claimed various sums of money to be paid by various defendants to the company, Film Finances Ltd., the ninth named defendant, upon whose behalf the plaintiffs claimed to sue, as E being minority shareholders of the company. Those claims were based on allegations that the eighth defendant, Brindeel Ltd., an associated company controlled by the company's executive directors, William Alan Croft, Richard Martin Francis Soames and David Alexander Korda (the first to third defendants) had purchased 19,900 shares in the company, with money borrowed from a bank; that Brindeel Ltd. had been F acquired by the executive directors on or about 11 June 1982 with a view to the purchase of the 19,900 shares; that each of three other associated companies controlled by the executive directors, Mannergrand Services Ltd., Cushingham Ltd., and Bellwedge Ltd. (the fifth to seventh defendants), had received £33,000 from the company in early August 1982, and had lent £28,000 to Brindeel Ltd. thereafter, and that these sums were used by Brindeel Ltd. to discharge its bank indebtedness. It G was alleged that the payments by the company to the associated companies constituted financial assistance for the purchase of its shares within the meaning of section 42(2) of the Companies Act 1981. The writ claimed also a declaration that Brindeel Ltd. held the 19,900 shares on constructive trust for the company absolutely, and an order for the payment by Brindeel Ltd. to the company of £71,640, and for damages for conspiracy. There was also a claim against the majority shareholders H and Michael Lewis Carr, the chairman and a non-executive director of the company (the fourth defendant), for interest under section 35A of the Supreme Court Act 1981, or under the court's inherent equitable jurisdiction. Further and other relief and costs were also claimed.

By a notice of motion dated 24 February 1986 the company applied for an order pursuant to R.S.C., Ord. 18, r. 19 or under the court's inherent jurisdiction, that the action be struck out as being frivolous, vexatious or an abuse of process, on the grounds that the plaintiffs were not in fact entitled to bring or to continue the same, and that the plaintiffs do pay the defendants' costs of the action to be taxed. By a further notice of motion, dated 17 March 1986 the fourth defendant sought an order, pursuant to R.S.C., Ord. 18, r. 19 or the court's inherent jurisdiction, that the action be similarly struck out on the grounds that the plaintiffs were not in fact entitled to bring the same, or alternatively that the action was obviously unsustainable against him (the fourth defendant), and that the plaintiffs do pay the defendant's costs of the action to be taxed.

The facts are stated in the ruling of 13 November 1986 and in the judgment of 19 December 1986.

Charles Aldous Q.C. and *Caroline Hutton,* for the company. This minority shareholders action is brought in respect of allegations of fraud and breach of duty by directors, allegedly on behalf of all shareholders other than the alleged wrongdoers. But it is strongly opposed by a majority of independent shareholders, and if the action goes ahead, the company may be killed by kindness ending up a worthless company. The action has already been before Walton J. (see *Smith v. Croft* [1986] 1 W.L.R. 580) on an application as to whether the plaintiffs should be allowed to continue the action at the company's expense. It was there held that it was clear from undisputed facts that the action had little chance of success and was being prosecuted against the wishes of the majority of the independently held shares, and accordingly that it would be unjust to grant the plaintiffs an indemnity for costs in bringing the action. Where the company may be damaged, the court should reach a determination as to the plaintiffs' right to bring this action, at an early stage.

This is a derivative action; the plaintiffs have no independent cause of action of their own. Where minority shareholders seek to recover for the benefit of the company sums paid away, and the defendants wish to challenge their locus standi to bring proceedings, on the basis that the rule in *Foss v. Harbottle* (1843) 2 Hare 461, prevents them from so doing, the proper procedure is by way of an application for striking out. It being an abuse of process for a person to bring an action for damages suffered by another, similarly it is an abuse of process for a minority shareholder in the circumstances of this case to bring an action on behalf of the company. A minority shareholder's right to sue on behalf of the company presupposes that the company is being controlled by wrongdoers. Where the company would be damaged by the conduct of the action, the court should rule upon the plaintiffs' right, if any, at an early stage. Where a majority of the independent shareholders are sufficiently informed and oppose the bringing of proceedings, the court ought to accede to their views: see *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204, 219, where the Court of Appeal has given clearly considered views as to the appropriate

A procedure. The grounds on which the defendants rely are essentially the same as those on which they relied before Walton J. [1986] 1 W.L.R. 580. The plaintiffs are unable to show a sufficient case even if the company itself were the plaintiff, they cannot produce evidence of fraud, ultra vires or illegality. In any event the action is contrary to the wishes of the independent majority of the minority shareholders. [Reference was made to *Devlin v. Slough Estates Ltd.* [1983] B.C.L.C. 497]. It
B would be totally illogical to demand the trial of a preliminary issue under R.S.C., Ord. 33, r. 3, which might necessitate hearing a very lengthy case in full, before being able to decide if there was a cause of action. Most of the relevant facts here are not in dispute, there being no real issue over the amounts paid to the directors, by way of salary, bonus or expenses.

C The court is invited to find that there is no prima facie case, even for the company, on either fraud, ultra vires or illegality. [Reference was made to *Gower, Modern Company Law,* 4th ed. (1979), pp. 641 to 644.] A distinction must be drawn between a personal action and a derivative one; the former is to restrain ultra vires or illegal acts or to enforce entrenched rights of shareholders; the latter to recover money or property or damages on behalf of the company, whether in respect of
D losses already sustained by reason of fraud or breach of duty, or in respect of ultra vires or illegal acts. There is no personal action to recover money or property already lost by reason of such matters. The principle is that where the wrongdoers are in control the court will not allow them to stifle the claim, whether based on fraud ultra vires or illegality, either by ratification, where the transaction is capable of being
E ratified, or by resolving not to sue. Although ultra vires transactions cannot be ratified, the company through an independent board or by shareholders' resolution can compromise proceedings already brought, or resolve not to sue, subject always to one proviso, namely that the decision taken is for proper reasons in the best interests of the shareholders, or maybe the creditors, if the company is on the verge of insolvency. Where there is no independent board, then the decision can
F be left to the shareholders. Where the compromise is bona fide in what the board considers to be in the best interests of the company, the compromise can bar individual shareholders from suing upon the same cause of action. Otherwise once litigation was begun it would have to be fought to a finish, unless every single shareholder were to agree to a compromise. If the company is under the control of an independent
G board then no individual shareholder can bring a derivative action at all; if there is no independent board then the question must rest with the independent shareholders as a body. The only exception is where the decision taken is not in the best interests of the company but amounts to oppression of or discrimination against the minority; see *Viscount of the Royal Court of Jersey v. Shelton* [1986] 1 W.L.R. 985, P.C.; *Pennington's Company Law,* 5th ed. (1985), p. 731 and two articles by Mr.
H Wedderburn on "Shareholders rights and the rule in *Foss v. Harbottle*" [1957] C.L.J. 194 and [1958] C.L.J. 93; *Burland v. Earle* [1902] A.C. 83. *Atwool v. Merryweather* (1867) L.R. 5 Eq. 464n seems to show that if the majority of the independent shareholders had not supported the

action in that case the court would have held the suit to be improperly framed. The only limit on the power of compromise would be where it would be a fraud on the minority or the creditors. The wrongdoers cannot use their voting power to oppress the minority; see *Cook v. Deeks* [1916] 1 A.C. 554, 557, 559–563; *Birch v. Sullivan* [1957] 1 W.L.R. 1247; *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1981] Ch. 257, 267, 304, 308, 326 and [1982] Ch. 204, 210, 219, C.A.; *Estmanco (Kilner House) Ltd. v. Greater London Council* [1982] 1 W.L.R. 2 and *Devlin v. Slough Estates Ltd.* [1983] B.C.L.C. 497. There has been some confusion in the authorities between the personal action, to recover personal loss, i.e. otherwise than through the company or to enforce the articles of association, and the derivative action, to recover damage caused to the company. In *Edwards v. Halliwell* [1950] 2 All E.R. 1064, 1065, although it concerns trade unions, the same principles are applicable. The statements of the law in the *Prudential Assurance v. Newman Industries* and in the *Estmanco* cases are of general application, although in both cases what was in issue was breaches of duty. In both those cases the company was the ultimate master of its action. On the question whether a minority shareholder can sue on the company's behalf, the onus of proof is not clear, but in the present case it is contended it matters not where the onus lies, because the evidence is overwhelming. It is necessary to see first in whom the cause of action is vested: if it is in the company, then the case is subject to wider considerations as to whether the minority shareholder can sue on its behalf.

The right of a company, acting through an independent board of directors or on a resolution of independent shareholders, to stop a derivative action stems from basic principles, and not from the rigid rules evolved in order to get round the rule in *Foss v. Harbottle,* 2 Hare 461. The basis of the rule is not confined to company law but is of wide general application. It must be appreciated that a company is free to decide whether or not to pursue a cause of action vested in it. Despite the rule in *Foss v. Harbottle* individual shareholders are entitled to have the company's memorandum and articles of association observed, under which shareholders have entrenched rights. An action to recover loss already sustained by the company, however it arises, is vested in the company, and can only be brought by individual shareholders on the company's behalf in certain circumstances. No personal action for such loss can be brought by an individual shareholder, the derivative action being a purely procedural device. The only circumstances in which an individual shareholder can sue, on the company's behalf, are cases where the company has failed or refused to do so, and where the loss has been sustained by ultra vires or illegal acts, or otherwise by a fraud on a minority. In each case the rationale behind the exception is because the act cannot be ratified either wholly or by those directly implicated. The rationale for both exceptions is that a shareholder is entitled to vote according to his own vested interests, and to ratify, retrospectively, matters complained of.

As a matter of general principle in company law, whether the transaction complained of can be ratified or not, a company acting

A through an independent board of directors, or pursuant to a resolution passed by a majority of independent shareholders can always compromise—or can waive the cause of action vested in it, provided only it does so for good practical reasons in what the board or the shareholders believe to be the company's best interests: see *Viscount of the Royal Court of Jersey v. Shelton* [1986] 1 W.L.R. 985. Such a compromise in waiver binds every shareholder, and defeats an action B already commenced. A plaintiff in a derivative action can be in no better position than the company itself; in the present case if a meeting were to be convened and a resolution passed by a majority of disinterested shareholders free from manipulation by the wrongdoers, then the present proceedings should be discontinued: it would plainly be wrong for the action to proceed. There is no prima facie case that the C company would succeed.

Walton J. was right in saying that the present case is primarily concerned with remuneration of directors. Payments made to them were undoubtedly ultra vires. While a company has the capacity to pay a fair and reasonable level of remuneration, to pay directors an excessive amount might well be fraud on a minority. [Reference was made to *In re George Newman & Co.* [1895] 1 Ch. 674; *In re Halt Garage (1964)* D *Ltd.* [1982] 3 All E.R. 1016, 1023–1033, 1039; *In re Horsley & Weight Ltd.* [1892] Ch. 442, 445, 448, 450, 452, 454, 455 and *Rolled Steel Products (Holdings) Ltd. v. British Steel Corporation* [1986] Ch. 246.] The articles give the directors power to fix their own remuneration, but a director's duty is nevertheless to act bona fide in what they consider to be in the interests of the company: *In re Smith & Fawcett Ltd.* [1942] E Ch. 304. The court will only interfere if no reasonable board of directors could have concluded that the level of remuneration was justified. *Palmer's Company Law,* 23rd ed. (1982), vol. 1, p. 851, paras. 64–66. No credible evidence as to the proper level in this field. Not only were the payments not ultra vires, they were in fact proper. Apart from a period in 1980–1981 all payments were disclosed at properly convened meetings. The following principles apply to voting:—(1) every shareholder F has a right to vote even though he has a direct personal interest, provided it is for the benefit of the general body of shareholders and not a fraud on creditors. (2) If validly authorised the act becomes the act of the company and no shareholder can therefore complain. (3) The onus of showing impropriety rests with the party attacking it. (4) To succeed the attacker must prove that no honest and intelligent person could have G thought that the level of remuneration paid to him was reasonable. (5) It is not the court's function to enter into the commercial field and to decide what is in the company's best interests. (6) The plaintiffs must be able to show a prima facie case. (7) The right of an interested shareholder to vote is in contrast to the case where there has been proven fraud or abuse of power, in which case the court will disregard their votes. [Reference was made to *North-West Transportation Co. Ltd.* H *v. Beatty* (1887) 12 App. Cas. 589; *Allen v. Gold Reefs of West Africa Ltd.* [1900] 1 Ch. 656; *Greenhalgh v. Arderne Cinemas Ltd.* [1951] Ch. 286 and *Dominion Cotton Mills Co. Ltd. v. Amyot* [1912] A.C. 546, 549, 551, 553.]

The only issue is whether the plaintiffs have shown a sufficient prima facie case that the payments were so excessive as to be fraud, so that the defendants, as shareholders, could not honestly have believed them to be justified. [Reference was made to *Multinational Gas and Petrochemical Co. v. Multinational Gas and Petrochemical Services Ltd.* [1983] Ch. 258 and *Gore-Browne on Companies,* 44th ed. (1986), vol. 2, para. 27.21.2.] Unless a decision of the shareholders is unanimous, an individual shareholder is entitled to complain of alleged fraud on a minority. Since the level of remuneration was opposed not only by the defendants but by Wren Trust Ltd., the plaintiffs would have to show mala fides or manipulation in respect of disinterested votes. If they cannot show either, then there is no logical reason to ascribe dishonesty to the defendants, when disinterested shareholders who agree with them are acting properly. [Reference was made to *In re Duomatic Ltd.* [1969] 2 Ch. 365; *Buckley on the Companies Acts,* 14th ed. (1981), vol. 2, p. 1594.] Even if some of the payments for some technical reason were not authorised at the time, they were subsequently ratified, which operates retrospectively: *Halsbury's Laws of England,* 4th ed. (1973), vol. 1, para. 768.

David Oliver Q.C. for the fourth defendant. The arguments advanced by Mr. Aldous are adopted. It is fundamental that the court will not interfere with the internal management of a company, in the absence of mala fides: *Burland v. Earle* [1902] A.C. 83. It is a corollary of the majority rule. Exceptions to this general rule are where the company is proposing to do some illegal act: this is logical since however large the majority it cannot authorise an illegal act, and the same applies in the case of ultra vires acts. No amount of authorisation can confer a capacity, which it does not possess. Once an ultra vires act has been done, the position is different. It is inappropriate, in the absence of bad faith, for the court to interfere in the decision as to what is to be done about what has happened. In so far as *Pennington's Company Law,* 5th ed. (1985) or Vinelott J. in the *Prudential Assurance v. Newman Industries* case [1981] Ch. 229 suggests otherwise, it is not supportable either on principle or on authority: the propositions there advanced are not supported by either: see *Spokes v. Grosvenor and West End Railway Terminus Hotel Co. Ltd.* [1897] 2 Q.B. 124, 126, 128 and *Salomons v. Laing* (1850) 12 Beav. 377, 381 or *Edwards v. Halliwell* [1950] 2 All E.R. 1064.

The real question is capable of a relatively simple formulation, namely, when will the court oppose the wishes of the majority. [Reference was made to *Clemens v. Clemens Bros. Ltd.* [1976] 2 All E.R. 268.] There are situations where sectional interests will deprive the votes cast of their validity. In this case the decision of Wren Trust Ltd. and Gresham Trust Ltd. are devoid of any sectional interests being merely for the protection of Wren's investment. Their votes are therefore not vitiated. The decision should not rest those shareholders who are not defendants in the action. [Reference was made to *Lawrance v. Lord Norreys* (1890) 15 App.Cas. 210, 215. Vinelott J.'s judgment in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd.* [1981] Ch. 229, 307 was criticised in the Court of Appeal but it actually contains a

A very sound analysis of the position: apart from his misreading of *Edwards v. Halliwell* [1950] 2 All E.R. 1064, and the justice of the case his judgment stands unblemished by the criticism. The plaintiffs' allegations of fraud etc. cannot be maintained. [Reference was made to *Wallersteiner v. Moir (No. 2)* [1975] Q.B. 373.]

Robin Potts Q.C. and *Daniel Serota* for the plaintiffs. The present applications are utterly misconceived. It is wholly inappropriate to B proceed by way of striking out under R.S.C., Ord. 18, r. 19, when what it is sought to contend is that the proceedings are suitable to be brought under the rule in *Foss v. Harbottle,* 2 Hare 461. The correct procedure, where a *Foss v. Harbottle* point is raised, is for the determination of an issue of law or fact. The Court of Appeal has specifically so stated in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] C Ch. 204. But no application has been made for trial of a preliminary issue. Such a trial is only available where there is a particular issue which can be precisely and readily defined, and which in isolation can effectively determine the action. That is not the position here. Virtually all the issues of fact or law arising in this case have been covered in argument by the defendants and there is no single issue that could determine the action. There has to be an order of court, deciding the D trial of a preliminary issue under R.S.C., Ord. 33, r. 3. In *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204 the issue was one of law, and in a limited respect, one of fact, the issue of law being whether Prudential could proceed with their action where there was no allegation in the pleadings, of control by wrongdoers, the issue of fact was whether the wrongdoers were in fact in control, since E they were not in control so far as voting was concerned. The issue in the present case is quite different; it involves a counting of heads in two stages, stage 1 being to ascertain whether the wrongdoers are in control, and stage 2 a counting of heads amongst the majority. This gives rise to a plethora of issues, both legal and factual.

The issues include the following: (i) Can a larger disinterested majority stop a smaller minority from suing on the company's behalf? (ii) If yes, F does the Wren Trust fulfil that position of disinterestedness? and (iii) What does the word "disinterested" or "independent" mean in law?

The plaintiffs contend that any one shareholder is entitled either to an injunction restraining an ultra vires transaction, or to a declaration that a transaction, if not yet implemented, would be ultra vires, or, if already completed, was ultra vires, and, where already completed, that the G plaintiffs are entitled to make the wrongdoing directors liable to compensate the company, or to make restitution, in that they are accounting parties. A minority shareholder is also entitled to maintain an action for "rescission." The plaintiffs contend that the moneys paid away were not remuneration or fees for services rendered, but were simply improper withdrawals. Questions of fact are involved as to the nature of any obligation to make the payments in question and as to the H state of mind of the payer in making the payment. The minority shareholders' right to maintain such an action is an individual right, although the relief claimed is payment to the company. Here the plaintiffs seek to have the payments set aside; where wrongdoers are in

control, there should be no counting of heads as to the minority. The court does not have any supervisory role, where the claim is by a minority shareholder and the wrongdoers are in control. It would not be appropriate to direct the trial of a preliminary issue, where the facts are in dispute. [Reference was made to *Western Steamship Co. Ltd. v. Amaral Sutherland & Co. Ltd.* [1914] 3 K.B. 55; *M. Isaacs and Sons Ltd. v. Cook* [1925] 2 K.B. 391; *National Real Estate and Finance Co. Ltd. v. Hassan* [1939] 2 K.B. 61 and *Morris v. Sanders Universal Products* [1954] 1 W.L.R. 67, 73.] It is hotly disputed that Wren Trust Ltd. can be regarded as independent or disinterested, the court could not be satisfied on this point without cross examination and discovery.

It is undesirable to decide a point of law which involves underlying facts which are in dispute: *Windsor Refrigerator Co. Ltd. v. Branch Nominees Ltd.* [1961] Ch. 375; *Richards v. Naum* [1967] 1 Q.B. 620; *Nissan v. Attorney-General* [1970] A.C. 179; *Tilling v. Whiteman* [1980] A.C. 1; *Radstock Co-operative and Industrial Society Ltd. v. Norton-Radstock Urban District Council* [1968] Ch. 605; *Lawrance v. Lord Norreys,* 15 App.Cas. 210 and *Wenlock v. Moloney* [1965] 1 W.L.R. 1238, 1242.]

Unless there is no doubt about the factual position, as set out in the affidavits, one should not be looking at the affidavits at all. [Reference was made to *Goodson v. Grierson* [1908] 1 K.B. 761, 766 and *Williams & Humbert Ltd. v. W. & H. Trade Marks (Jersey) Ltd.* [1986] A.C. 368, 416, 434, 436, 441.] A striking out application is inappropriate unless it is going to determine the substantive issues. [Reference was made to *City of London Corporation v. Horner* (1914) 111 L.T. 512, 514 and *Electrical Development Co. of Ontario v. Attorney-General for Ontario* [1919] A.C. 687.] In determining whether Wren Trust Ltd. is an independent shareholder it is essential to know the motives for their expressed opposition.

The striking out procedure is wholly inappropriate, because the question is not plain and obvious: *Salomons v. Laing,* 12 Beav. 377; *Bagshaw v. Eastern Union Railway Co.* (1849) 7 Hare 114; *Russell v. Wakefield Waterworks Co.* (1875) L.R. 20 Eq. 474, 481, 482. [Reference was also made to *W. E. Paterson, H. A. Ednie & H. A. J. Ford on Australian Company Law* (Butterworths) 33/12; *Hichens v. Congreve* (1828) 4 Russ. 562; *Mozley v. Alston* (1847) 1 Ph. 790, 798, 801; *Lord v. Governor and Company of Copper Miners* (1848) 2 Ph. 740, 747, 748, 751, 752.] In *Burt v. British Nation Life Assurance Association* (1859) 4 De G. & J. 158, 174, Knight Bruce L.J. contemplates the possibility of a single shareholder bringing an action on behalf of himself and all other shareholders, although all the others were against it. [Reference was made to *Simpson v. Westminster Palace Hotel Co.* (1860) 8 H.L. Cas. 712, 714, 716–719; *Davidson v. Tulloch* (1860) 3 Macq. 783, 786, 789, 791, 796; *Orr v. Glasgow, Airdrie and Monklands Junction Railway Co.* (1860) 3 Macq. 799, 802; *Gregory v. Patchett* (1864) 33 Beav. 595, 597.] If something is ultra vires, an individual shareholder has an individual right to sue for compensation, on behalf of the company: *Hoole v. Great Western Railway Co.* (1867) L.R. 3 Ch.App. 262, 266–268, 272, 274; *Clinch v. Financial Corporation* (1868) L.R. 5 Eq. 450, 469, 474, 482

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A and L.R. 4 Ch.App. 117, 120, 122; *Gray v. Lewis* (1869) L.R. 8 Eq. 526, 534, 536, 539, 541 and (1873) L.R. 8 Ch.App. 1035, 1049, 1050, 1051 and *Pickering v. Stephenson* (1872) L.R. 14 Eq. 322, 329, 331.

Aldous Q.C. in reply on procedure. Pure question of law can be decided on motion. *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204 was not concerned with control, since the B wrongdoers did not have voting control. The real issue was whether the board was independent, or was being manipulated: could they safely be relied on to decide whether the action should go ahead? It cannot be right to argue that complex questions of law have to go to trial. The plaintiffs must show a prima facie case, otherwise the proceedings must be struck out. The court has to ask the same questions, whether the procedure is by striking out under R.S.C., Ord. 18, r. 19, or is by way C of trial of a preliminary issue under R.S.C., Ord. 33. [Reference was made to *Dominion Cotton Mills Co. Ltd. v. Amyot* [1912] A.C. 546 and *Carter v. Commissioner of Police of the Metropolis* [1975] 1 W.L.R. 507].

Oliver Q.C. in reply on procedure. Strong objection is taken to allegations of mala fides, which appears nowhere in any sworn evidence D of the plaintiffs. Either the striking out procedure or the trial of a preliminary issue would be appropriate. But striking out would be the better procedure. [Reference was made to *Russian Commercial and Industrial Bank v. Comptoir D'Escompte de Mulhouse* [1925] A.C. 112, 119.]

Potts Q.C. in rejoinder. There is a clear confusion between the ambit of R.S.C., Ord. 18, r. 19 and R.S.C., Ord. 33, the latter being a trial. E In the former case the burden of proof lies on the applicant (i.e. the defendant here). [Reference was made to *Daniels v. Daniels* [1978] Ch. 406 and *Carter v. Commissioner of Police of the Metropolis* [1975] 1 W.L.R. 507.]

13 November 1986. KNOX J. I have to give a ruling in relation to F two motions that are before me. The first is a motion by the ninth defendant, Film Finances Ltd. ("the company") for an order pursuant to R.S.C., Ord. 18, r. 19, or under the inherent jurisdiction of the court that this action be struck out as being frivolous or vexatious or an abuse of the process of the court on the ground that, the proceedings being purportedly brought by the plaintiffs on behalf of the ninth defendant, G the plaintiffs are in fact not entitled to bring or continue the same. There is an application with regard to costs.

The other notice of motion is one by the fourth defendant, Michael Lewis Carr, in terms very similar to the first motion, for an order pursuant to R.S.C., Ord. 18, r. 19 or under the inherent jurisdiction, that this action be struck out as being frivolous or vexatious or an abuse of the process of the court on the grounds that the proceedings being H purportedly brought by the plaintiffs on behalf of the ninth defendant, the plaintiffs are in fact not entitled to bring or continue the same, and then there is an additional ground: "alternatively that the same is obviously unsustainable against the fourth defendant." I am not

concerned, in relation to this ruling, with that second ground in the second notice of motion. A

The ruling which I have to make falls really into two parts. First, is the procedure, which it will be seen has been adopted by those two defendants, an application under R.S.C., Ord. 18, r. 19 and the inherent jurisdiction, appropriate at all to this type of proceeding? Secondly, if that question is answered in the affirmative, should these two applications be dismissed because the questions raised thereby do not have plain and obvious answers? It is not disputed but that difficult questions of law arise. If the right test to apply is that the applications should be dismissed unless the court is satisfied that the plaintiffs are bound to fail in the action without going in detail into the legal issues raised, then it is not disputed but that that test is not satisfied. It is common ground between the parties, and those familiar with the complications of the rule in *Foss v. Harbottle* (1843) 2 Hare 461 will not find this a matter of surprise, that difficult questions do arise. B C

I have not heard full argument from the respondents to the notices of motion, the plaintiffs in the action, on these issues of law, or on the issue of fact which I will mention in a moment. In those circumstances I do not propose to say anything about such preliminary views as I may have formed regarding those issues, whether of law or of fact. The action is one brought by the three plaintiffs, who are minority shareholders in the company, in respect of payments that have been made out of the company's funds and which, for a variety of reasons, the plaintiffs claim were improperly paid, and should be recouped to the company. The action has in fact been before the court already, and was the subject of a decision by Walton J. on 27 January 1986: see *Smith v. Croft* [1986] 1 W.L.R. 580. By that decision Walton J. discharged some earlier orders that were made by Master Chamberlain. The first of those earlier orders authorised the plaintiffs to bring these proceedings, down to the conclusion of discovery and inspection of documents, on terms that the company should indemnify the plaintiffs against the costs, putting it shortly. The master's later order was ancillary to that earlier one, and authorised the plaintiffs to have periodic taxation, and for a payment to them of the proportion of the costs thereby certified by the taxing master. Those orders were made on the authority of the Court of Appeal's decision in *Wallersteiner v. Moir (No. 2)* [1975] Q.B. 373. D E F

On 3 July 1986 leave to appeal from Walton J.'s order was granted by a single judge of the Court of Appeal, May L.J., who said:

> "I think I had better direct that this appeal [should] not be heard until after the application to strike out,"—which is the application before me—"because if it is struck out then, as I have said, the question does not arise, and this appeal falls naturally by the wayside. To the extent that it is struck out [it] may affect the exercise of the Court of Appeal's discretion if they come to the conclusion that the judge below exercised his discretion wrongly so that they have the opportunity of exercising their own." G H

It is, therefore, necessary that this application be disposed of, at least unless there is some serious delay for external reasons, before the

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appeal, which is pending in the Court of Appeal from that decision of Walton J., is heard.

The issues in the action need not be analysed in any detail for the purposes of this application, but it is desirable that I should state briefly what seem to me to be the issues that arise in the application to strike out, assuming of course that it proceeds. There are two issues of law and one of fact. The first issue of law can perhaps be stated in this way. Are actions to recover money paid away ultra vires by a company altogether outside the rule in *Foss v. Harbottle*, 2 Hare 461, so that even one shareholder can bring such actions? I interpose to mention that it is not disputed but that actions to restrain threatened ultra vires acts do fall within that category of cases outside the rule in *Foss v. Harbottle.* But the issue that arises between the parties is how far that state of affairs obtains in relation to past and completed transactions.

The second issue arises if the first is answered in the negative, and it can be stated in this way. Should the views of an independent majority of shareholders, on the question whether the action should proceed, prevail, if all the votes, either controlled or exercised or influenced by those accused of wrongdoing, are excluded from the computation, so that only independent votes are counted? If that question is answered in the affirmative then a question of fact would appear to arise, namely whether the votes of one particular shareholder, Wren Trust Ltd., should be treated as being independent for the purposes of that exercise.

The procedure which has been sought to be followed by the two defendants who issued notices of motion, is based firmly, and indeed I think exclusively, on what fell from the Court of Appeal in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204. I do not propose to read the very lengthy headnote in that case, which was also concerned with the rule in *Foss v. Harbottle*, but which was in fact concerned with a case where there was quite clearly no voting control. That is different from this case, where equally clearly the defendants in these proceedings do have voting control. Also it was a case where there was no allegation of ultra vires as such, as a principal issue in the action. But the Court of Appeal, after an examination of what the rule in *Foss v. Harbottle* was about, said, at p. 219:

> "It is commonly said that an exception to the rule in *Foss v. Harbottle* arises if the corporation is 'controlled' by persons implicated in the fraud complained of, who will not permit the name of the company to be used as plaintiffs in the suit: see *Russell v. Wakefield Waterworks Co.* (1875) L.R. 20 Eq. 474, 482. But this proposition leaves two questions at large, first, what is meant by 'control,' which embraces a broad spectrum extending from an overall absolute majority of votes at one end, to a majority of votes at the other end, made up of those likely to be cast by the delinquent himself plus those voting with him as a result of influence or apathy. Secondly, what course is to be taken by the court if, as happened in *Foss v. Harbottle*, in the *East Pant Du* case (1864) 2 Hem. & M. 254 and in the instant case, but did not happen in *Atwool v. Merryweather* (1867) L.R. 5 Eq. 464n, the court is confronted by a motion on the part of the delinquent or by the

company, seeking to strike out the action? For at the time of the application the existence of the fraud is unproved. It is at this point that a dilemma emerges. If, upon such an application, the plaintiff can require the court to assume as a fact every allegation in the statement of claim, as in a true demurrer, the plaintiff will frequently be able to outmanoeuvre the primary purpose of the rule in *Foss v. Harbottle* by alleging fraud and 'control' by the fraudster. If on the other hand the plaintiff has to prove fraud and 'control' before he can establish his title to prosecute his action, then the action may need to be fought to a conclusion before the court can decide whether or not the plaintiff should be permitted to prosecute it. In the latter case the purpose of the rule in *Foss v. Harbottle* disappears. Either the fraud has not been proved, so cadit quaestio; or the fraud has been proved and the delinquent is accountable unless there is a valid decision of the board or a valid decision of the company in general meeting, reached without impropriety or unfairness, to condone the fraud.

"We think that this brief look at the authorities is sufficient for present purposes. For it so happens that this court cannot properly on this appeal decide the scope of the exception to the rule in *Foss v. Harbottle.*"

And then the Court of Appeal goes on to explain the reason why that was so, which is special to that case, and put quite briefly it was that the company decided to adopt the action at the end of the day. Passing over those two paragraphs I pick it up at p. 220:

"It was in the light of these considerations that we declined to hear any argument from Mr. Caplan and Mr. Curry on the topic of *Foss v. Harbottle.* However desirable it might be in the public interest that we should express our conclusions on Vinelott J.'s analysis of the rule in *Foss v. Harbottle* and what he saw as the exception to it, it was necessary for us to bear in mind that the rule had ceased to be of the slightest relevance to the case. It would have been a grave injustice to all parties to increase the already horrendous costs of this litigation by allowing time for argument on an interesting but irrelevant point. Such consideration of the law as appears in this judgment is, apart from a few submissions made by Mr. Bartlett, merely a reflection of our own thoughts without the benefit of sustained argument.

"In the result it would be improper for us to express any concluded view on the proper scope of the exception or exceptions to the rule in *Foss v. Harbottle.* We desire, however, to say two things. First, as we have already said, we have no doubt whatever that Vinelott J. erred in dismissing the summons of 10 May 1979. He ought to have determined as a preliminary issue whether the plaintiffs were entitled to sue on behalf of Newman by bringing a derivative action. It cannot have been right to have subjected the company to a 30-day action (as it was then estimated to be) in order to enable him to decide whether the plaintiffs were entitled in law to subject the company to a 30-day action. Such an approach

defeats the whole purpose of the rule in *Foss v. Harbottle* and sanctions the very mischief that the rule is designed to prevent. By the time a derivative action is concluded, the rule in *Foss v. Harbottle* can have little, if any, role to play. Either the wrong is proved, thereby establishing conclusively the rights of the company; or the wrong is not proved, so cadit quaesio. In the present case a board, of which all the directors save one were disinterested, with the benefit of the Schroder-Harman report, had reached the conclusion before the start of the action that the prosecution of the action was likely to do more harm than good. That might prove a sound or unsound assessment, but it was the commercial assessment of an apparently independent board. Obviously the board would not have expected at that stage to be as well informed about the affairs of the company as it might be after 36 days of evidence in court and an intense examination of some 60 files of documents. But the board clearly doubted whether there were sufficient reasons for supposing that the company would at the end of the day be in a position to count its blessings; and clearly feared, as counsel said, that it might be killed by kindness. Whether in the events which have happened Newman (more exactly the disinterested body of shareholders) will feel that it has all been well worth while, or must lick its wounds and render no thanks to those who have interfered in its affairs, is not a question which we can answer. But we think it is within the bounds of possibility that if the preliminary issue had been argued, a judge might have reached the considered view that the prosecution of this great action should be left to the decision of the board or of a specially convened meeting of the shareholders, albeit less well informed than a judge after a 72-day action.

"So much for the summons of 10 May. The second observation which we wish to make is merely a comment on Vinelott J.'s decision that there is an exception to the rule in *Foss v. Harbottle* whenever the justice of the case so requires. We are not convinced that this is a practical test, particularly if it involves a full-dress trial before the test is applied. On the other hand we do not think that the right to bring a derivative action should be decided as a preliminary issue upon the hypothesis that all the allegations in the statement of claim of 'fraud' and 'control' are facts, as they would be on the trial of a preliminary point of law. In our view, whatever may be the properly defined boundaries of the exception to the rule, the plaintiff ought at least to be required before proceeding with his action to establish a prima facie case (i) that the company is entitled to the relief claimed, and (ii) that the action falls within the proper boundaries of the exception to the rule in *Foss v. Harbottle*. On the latter issue it may well be right for the judge trying the preliminary issue 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."

There is there, of course, a reference to the summons of 10 May, and it appears from the report of the decisions at first instance, the first of the

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two, by Vinelott J., what the nature of that summons was. In the same case, *Prudential Assurance Co. Ltd. v. Newman Industries Ltd.* [1981] Ch. 229, 233, one finds: A

> "In those circumstances"—that is the circumstances that obtained at the beginning of the proceedings—"the second and third defendants took out a summons asking for an order, under R.S.C., Ord. 33, r. 3, that it be determined as a preliminary issue whether as a matter of law the plaintiff was entitled to maintain the action against them. A similar application was made by T.P.G." B

There is therefore, as it seems to me, no doubt but that Mr. Potts is right in submitting that what was before the Court of Appeal was a summons under R.S.C., Ord. 33. There was in fact no appeal on that summons, but it was that summons that they were concerned with in making the references to preliminary issue so far as those proceedings were concerned. C

Mr. Potts further submitted that the fact that the onus of proof is clearly cast, in that passage which I have read from the Court of Appeal, on the plaintiffs of showing a prima facie case on those two matters indicates that it was a reference to the procedure under R.S.C., Ord. 33, r. 3 rather than that under R.S.C., Ord. 18, r. 19 that the Court of Appeal had in mind. R.S.C., Ord. 18, r. 19 reads: D

> "(1) The court may at any stage of the proceedings order to be struck out or amended any pleading or the indorsement of any writ in the action, or anything in any pleading or in the indorsement, on the ground that—(*a*) it discloses no reasonable cause of action . . . or (*b*) it is scandalous, frivolous or vexatious; or (*c*) it may prejudice, embarrass or delay the fair trial of the action; or (*d*) it is otherwise an abuse of the process of the court; and may order the action to be stayed or dismissed or judgment to be entered accordingly, as the case may be. (2) No evidence shall be admissible on an application under paragraph (1)(*a*)." That is, that it discloses no reasonable cause of action or defence as the case may be. E F

The whole of R.S.C., Ord. 33 is preceded by the heading "Place and mode of trial" and rule 3, under a heading "Time, etc. of trial of questions or issues," provides:

> "The court may order any question or issue arising in a cause or matter, whether of fact or law or partly of fact and partly of law, and whether raised by the pleadings or otherwise, to be tried before, at or after the trial of the cause or matter, and may give directions as to the manner in which the question or issue shall be stated." G

Mr. Aldous and Mr. Oliver have submitted to me that the proper procedure in such a case as this, where minority shareholders are seeking to bring an action to recover for the benefit of the company in which they are shareholders sums paid away and the defendants wish to challenge that on the basis that the rule in *Foss v. Harbottle*, 2 Hare 461 prevents such a proceeding, is for there to be an application by way of H

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striking out, mainly on the ground that this is the appropriate relief in relation to a challenge to the locus standi of a plaintiff, and that it is the inevitable result if the application succeeds. Secondly they submit that the Court of Appeal has given clearly considered views of the procedure, which they submitted were not intended to refer to Ord. 33, r. 3. In reliance on that, they pointed to the reference to striking out in a passage which I have in fact read in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204, 219, the actual sentence being:

> "Secondly, what course is to be taken by the court if, as happened in *Foss v. Harbottle*, in the *East Pant Du* case, 2 Hem. & M., 254 and in the instant case, but did not happen in *Atwool v. Merryweather*, L.R. 5 Eq. 464n the court is confronted by a motion on the part of the delinquent or by the company, seeking to strike out the action?"

And at that point they submitted that the Court of Appeal was clearly contemplating what must at its lowest be a possible form of procedure. Equally they pointed to an earlier passage which I have not read but which is quite short, which shows the sort of procedure that the Court of Appeal contemplated, at p. 212:

> "The assertion by Newman's counsel that the independent board 'was powerless to prevent the Prudential from pursuing the action' may have been based on the supposition that the plaintiffs had on the facts alleged in the statement of claim a personal cause of action for damages against Mr. Bartlett and Mr. Laughton independently of Newman's cause of action for damages. This supposition, if it existed, was erroneous for reasons which we explain later. It would have been open to Newman to have issued its own summons before the trial in order to test the right of the Prudential to pursue a derivative action, and to have supported it with evidence proving the objectiveness of the board's view and explaining the potential injury to Newman which would be caused by the proceedings."

That, they say, indicates the sort of procedure which the Court of Appeal envisaged as a possibility.

There has been a decision of the House of Lords, in connection with the interrelationship between R.S.C., Ord. 33, r. 3 and R.S.C., Ord. 18, r. 19. The decision is *Williams and Humbert Ltd. v. W. & H. Trade Marks (Jersey) Ltd.* [1986] A.C. 368, and there is a passage in the speech of Lord Templeman, at p. 435:

> "In *Hubbuck & Sons Ltd. v. Wilkinson* [1899] 1 Q.B. 86 Sir Nathaniel Lindley M.R. pointed out the distinction between Ord. 18, r. 19 (then Ord. xxv, r. 4), which dealt with striking out and Ord. 33, r. 3 (then Ord. xxv, r. 2), which enables a point of law to be set down and argued as a preliminary issue. He said, at p. 91: 'Two courses are open to a defendant who wishes to raise the question whether, assuming a statement of claim to be proved, it entitles the plaintiff to relief. One method is to raise the question of law as directed by Ord. xxv, r. 2; the other is to apply to strike out

the statement of claim under Ord. xxv, r. 4. The first method is appropriate to cases requiring argument and careful consideration. The second and more summary procedure is only appropriate to cases which are plain and obvious, so that any master or judge can say at once that the statement of claim as it stands is insufficient, even if proved, to entitle the plaintiff to what he asks.' The observations of Lindley M.R. directed to striking out a statement of claim apply equally to applications to strike out a defence or part of a defence. There has been recently a difference of judicial approach to the construction of Ord. 18, r. 19. In *McKay v. Essex Area Health Authority* [1982] Q.B. 1166, the majority of the Court of Appeal (Stephenson and Ackner L.JJ.) cited with approval the observations of Sir Gordon Willmer in *Drummond-Jackson v. British Medical Association* [1970] 1 W.L.R. 688, 700 where he said: 'The question whether a point is plain and obvious does not depend upon the length of time it takes to argue. Rather the question is whether, when the point has been argued, it has become plain and obvious that there can be but one result.' On the other hand, Griffiths L.J. dissented on the point in *McKay v. Essex Area Health Authority* [1982] Q.B. 1166 and said, at p. 1191: 'If on an application to strike out as disclosing no cause of action a judge realises that he cannot brush aside the argument, and can only decide the question after a prolonged and serious legal argument, he should refuse to embark upon that argument and should dismiss the application unless there is a real benefit to the parties in determining the point at that stage. For example, where striking out the cause of action will put an end to the litigation a judge may well be disposed to embark on a substantial hearing because of the possibility of finally disposing of the action. But even in such a case the judge must be on his guard that the facts as they emerge at the trial may not make it easier to resolve the legal question.' My Lords, if an application to strike out involves a prolonged and serious argument the judge should, as a general rule, decline to proceed with the argument unless he not only harbours doubts about the soundness of the pleading but, in addition, is satisfied that striking out will obviate the necessity for a trial or will substantially reduce the burden of preparing for trial or the burden of the trial itself. In the present case, the general rule would seem to require a refusal by the judge to embark on the problems of international law involved in the present appeal, leaving those problems to be solved at the trial if they become material. If at the trial the appellants were cleared of any impropriety in their management of the affairs of the Rumasa group, then the problems of international law would not arise. Moreover, even if those problems did arise I do not believe that the length of time, namely seven days, occupied by the judge in deciding to strike out the pleadings would have been added to the time required to decide other issues. But there are special circumstances which, in my view, made it right for the judge to proceed and to make the order which he made. If the appellants' pleadings and particulars had not been struck out, the appellants

A would have proceeded to demand discovery before trial and to lead evidence at the trial, harassing to the plaintiffs and embarrassing to the court and designed to support the allegations and insinuations of oppression and bad faith on the part of the Spanish authorities which appear in the amended defences and particulars. These allegations are irrelevant to the trade marks action and the banks' action and are inadmissible as a matter of law and comity and were B rightly disposed of at the first opportunity."

In my judgment it appears from what fell from Lord Templeman in that case, that even in the type of case where the issue in the preliminary application is one of the issues in the action, there may be circumstances which overall justify the use of Ord. 18, r. 19 where equally Ord. 33, C r. 3 might serve. It depends in my judgment on the particular facts of the particular case.

A further point which was relied upon by Mr. Aldous and Mr. Oliver was that the parties were in this case armed and prepared both with leading counsel and a multitude of books to argue the issues which were clear to them some time before the proceedings came before me, and that it was only at the last moment that an objection to the form of D procedure was made. I do not regard that as a determinant factor in any sense since either the point is a good one or it is not, and the lateness with which it was in fact taken does not impinge on that. On the other hand, it is capable of being relevant that the issues were sufficiently defined for the parties to prepare themselves, and that the matter was organised for trial by earlier applications on the notices of motion when E the time of trial was estimated without doubts being raised as to the propriety of the procedure.

I am satisfied that the statements which I have read in the Court of Appeal as to the procedure to be adopted in these matters, although plainly obiter as was in fact conceded, should be regarded by me as a guide to be followed as faithfully as possible. In my judgment, as a matter of procedural law, either Ord. 18, r. 19 or Ord. 33, r. 3 is a F potentially possible vehicle for such an application as is involved in the present case to decide whether a plaintiff minority shareholder has the necessary locus standi. But for present purposes it is sufficient for my decision to hold, as I do, that the procedure under Ord. 18, r, 19 is not of itself an impossible procedure which leads to an application, made under that rule or under the inherent jurisdiction, to be struck out as G being evidently improper. It seems to me that although the Court of Appeal undoubtedly had Order 33 procedure before it in the form of the summons in relation to which they were discussing the propriety of what had happened below, their guidance was intended to be general in relation to minority shareholders' actions, and on that basis I find that the procedure is not inherently defective.

That leads me to the second of the two issues with which I am faced, H and that is the effect of the answer to the problems that are raised not being plain or obvious. Mr. Potts has relied on two separate lines of very well established authority, one on Ord. 18, r. 19, which is summarised conveniently at p. 305 of *The Supreme Court Practice 1985*

under the rubric "Exercise of powers under this rule," the note being numbered 18/19/3, where the text reads:

> "It is only in plain and obvious cases that recourse should be had to the summary process under this rule . . . The summary procedure under this rule can only be adopted when it can be clearly seen that a claim or answer is on the face of it 'obviously unsustainable' . . . The summary remedy under this rule is only to be implied in plain and obvious cases when the action is one which cannot succeed or is in some way an abuse of the process or the case unarguable . . . It cannot be exercised by a minute and protracted examination of the documents and facts of the case, in order to see whether the plaintiff really has a cause of action . . ."

As a typical example of this type of authority he cited, along with other cases, the decision in *Wenlock v. Moloney* [1965] 1 W.L.R. 1238, where the headnote reads:

> "By his writ and statement of claim the plaintiff claimed damages against the three defendants for conspiring to oust him from the business of a company. His original statement of claim was a long, inartistic and wandering document to which the defendants refused to plead. He, accordingly, remodelled it and delivered a second statement of claim in which he alleged the conspiracy and set out four stages of the conspiracy at various times between January 1961 and January 1964 as a result of which he alleged, inter alia, that he had been deprived of his shares and interest in the company. The defendants delivered defences denying the allegations made against them in the statement of claim, and sought further and better particulars of the statement of claim which the plaintiff gave. After the pleadings were closed the plaintiff issued a summons for directions in the ordinary way, but before it was heard the defendants applied to the master under R.S.C., Ord. 18, r. 19, alternatively under the inherent jurisdiction of the court, to strike out the pleadings and dismiss the action on the grounds that the pleadings disclosed no reasonable cause of action, were frivolous and vexatious, and an abuse of the process of the court. On the hearing of the applications to strike out, ten affidavits were filed, five by the defendants in support of the applications and five by the plaintiff in opposition thereto. The master read the affidavits, the documents exhibited thereto, and considered the issues of fact raised by the affidavits in a four-day hearing. There was no cross-examination on the affidavits or oral evidence. In his reserved judgment, which occupied 22 pages, the master held that the plaintiff's action was most unlikely to succeed and he, accordingly, struck out the pleadings and the action. The plaintiff appealed to the judge in chambers, who dismissed his appeal.
>
> "On appeal to the Court of Appeal, which refused to look at the affidavits:—
>
> "*Held*, allowing the appeal, that the trial by the master of issues of fact on affidavits to ascertain whether the plaintiff had a case was a usurpation of the functions of the trial judge and was a wholly

A improper procedure . . . and that since the pleadings on their face disclosed a reasonable cause of action and raised issues of fact which required to be determined on oral evidence by a judge, the action would not be struck out but would proceed to trial."

Danckwerts L.J. said, at p. 1243:

B "The practice under R.S.C., Ord. 25, r. 4, and under the inherent jurisdiction of the court was well settled. Under the rule it had to appear on the face of the plaintiff's pleading that the action could not succeed or was objectionable for some other reason. No evidence could be filed. In the case of the inherent power of the court to prevent abuse of its procedure by frivolous or vexatious proceedings or proceedings which were shown to be an abuse of the C process of the court, an affidavit could be filed to show why the action was objectionable. The commonest case was where a plaintiff was seeking to bring an action on a point which had already been decided or was obviously wholly imaginary. An example of that is *Willis v. Earl Howe* [1893] 2 Ch. 545. But, as the procedure was of a summary nature, the party was not to be deprived of his right to have his case tried by a proper trial, unless the matter was clear."

D

And he went on to quote Lord Herschell in *Lawrance v. Lord Norreys* (1890) 15 App.Cas. 210, 219 where he said:

"It cannot be doubted that the court has an inherent jurisdiction to dismiss an action which is an abuse of the process of the court. It is a jurisdiction which ought to be very sparingly exercised, and only E in very exceptional cases."

That was one line of authority on which Mr. Potts relied. The other line of authority is concerned with the trial of preliminary issues, but Mr. Potts relied on that as being equally applicable, and in that context I cite again, as an example of the numerous cases that were cited, the decision of *Windsor Refrigerator Co. Ltd. v. Branch Nominees Ltd.* [1961] Ch. F 375. I need not read the headnote, but Lord Evershed M.R. summed up the principle involved at the end of his judgment, saying, at p. 396:

"For the reasons that I have stated, I conclude that the answer to this case is that on the assumptions of fact which I have indicated— which can be determined only in the action—this instrument would be capable of being a writing as contemplated by the debenture G taking effect on the date (28 February) when it was in fact, according to the defendants, passed over to Greenwood after a demand had been made by Inkin with the authority of the debenture holders. I would, therefore, order accordingly, and set aside the judgment of Cross J., though, as I say, I do not express any view upon the matter with which he expressly dealt, namely, whether the document took effect in the circumstances (or was capable of taking H effect) as a deed. I repeat what I said at the beginning, that the course which this matter has taken emphasises, as clearly as any case in my experience has emphasised, the extreme unwisdom— save in very exceptional cases—of adopting this procedure of

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preliminary issues. My experience has taught me (and this case emphasises the teaching) that the shortest cut so attempted inevitably turns out to be the longest way round." A

Harman L.J. said, at p. 396:

"I concur, and find myself doing so with particular heartiness with reference to the last observations my Lord has made. The number of conditions he has found it necessary to use to fence in the expression of this court's opinion shows at once the undesirability of this kind of procedure. It is highly undesirable that the court should be constrained to tie itself in so many knots, and in the end merely say: 'Well, if this was thus, then that was so.' " B

That highlights, in a typically trenchant way, the proposition that it is often profoundly unsatisfactory for a court to give a decision as a preliminary matter in an action on an individual issue on various hypothetical bases of fact. The plain objection being that the hypothetical bases may prove not to be bases and illusory, and in those circumstances the decision of the court is so much air. C

Both those lines of authority were distinguished by Mr. Aldous and Mr. Oliver on one single basis, and that is that they were without exception concerned with the interlocutory disposal of an issue which was going to form part of the issues in the action, and they submit that that is a piecemeal way of carrying on which is inherently open to the objections both under the inherent jurisdiction and under Ord. 18, r. 19 where there has to be a very obvious case before the issues can in effect be short-circuited, and to the preliminary trial of issues on assumed facts under Ord. 33, r. 3. In the present case they submit we have a fundamentally different situation, namely one where what has to be done is not to decide an issue in the action itself but an issue which the Court of Appeal has described in the way which I have read, namely whether a prima facie case on those two points has in fact been established by the plaintiff, and it is at least possible, and in many cases probable—and they would submit in this case near certain—that the issue there is not one which would occupy the court at the final trial of the action. D E F

They support their submissions by further submissions that it is plain from the passage which I read from Danckwerts L.J.'s decision in the *Windsor Refrigerator* case [1961] Ch. 375, 396, and indeed from many other passages, that questions of fact can be gone into under Ord. 18, r. 19, and in exceptional cases cross-examination can be permitted on affidavits. In this particular case the principal affidavit on which the defendants rely in relation to the issue of fact which I have mentioned as the third of the potential issues in these applications is one sworn by Mr. Baldock and cross-examination was in fact offered during the course of the hearing on a number of different occasions but never applied for by Mr. Potts, and it would not be in accordance with the practice of this court to direct a cross-examination without an application for it. But my conclusion is that it is the question stated by the Court of Appeal as a preliminary matter that has to be decided, that it is a special form of procedure concerned with giving sensible operation to the rule in *Foss v.* G H

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A *Harbottle*, 2 Hare 461 and which was concerned with avoiding the Scylla and Charybdis, on the one hand of having a preliminary issue which effectively requires one to try the whole action where the rule serves no useful purpose, and on the other side of the strait, of assuming that everything that the plaintiffs allege is necessarily correct as a matter of fact, which is of course the technique the court adopts when it has what was called a strict demurrer. The Court of Appeal, it seems to me, has B laid down a halfway house for this very special type of case, one in which the legal issues in this particular case are sufficiently well defined for the parties to be able to argue them. Further, I am satisfied that they will determine the result of the action completely if answered in one particular way—not if answered in the other way, but that is seldom obtainable.

C As regards the factual issue which I have sought to outline, that is to say the independence of Wren Trust Ltd., in my judgment that lies within a sufficiently small compass and is sufficiently independent of what I take to be the issues in the action itself for it to fall outside the lines of authority that Mr. Potts has cited and whose validity inside their scope is unchallenged. I do not propose to analyse the evidence in relation to the independence or otherwise of Wren Trust Ltd., it would D be both impracticable and undesirable for me to do so not having had the benefit of submissions from Mr. Potts in relation to the evidence that is at present before the court. I therefore confine my observations exclusively to the question whether the existence of that issue of fact is a fatal obstacle to the adoption of the procedure which has in fact been chosen by the two defendants who have moved these motions before E me, and to that extent I am not satisfied that there is any such fatal objection. Although, therefore, I view with mounting apprehension the escalation of authority which seems inevitably attendant on the difficult questions that arise in this case, I have reached the firm conclusion that it would not be right for me to stop these applications at this stage, and I so rule.

F

Order accordingly.
Costs reserved.

The hearing of the motions to strike out was then continued.

Potts Q.C. continuing on the main case. The cases cited so far have G all been concerned with ultra vires, or internal management; none of them has dealt with fraud on a minority. *Atwool v. Merryweather* (1867) L.R. 5 Eq. 464n clearly shows that where a contract entered into by the company is void, different considerations apply. [Reference was made to *MacDougall v. Gardiner* (1875) L.R. 20 Eq. 383 and (1875) 1 Ch.D. 13; *Menier v. Hooper's Telegraph Works* (1874) L.R. 9 Ch.App. 350 and *Mason v. Harris* (1879) 11 Ch.D. 97, 101.]

H There is no case, relating to a fraud on a minority, which indicates that the court can go beyond seeing whether the wrongdoers are in control, or is concerned to see what other, independent shareholders think. In *Mason v. Harris* (1879) 11 Ch.D. 97 there were a number of

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such independent shareholders. [Reference was made to *Studdert v. Grosvenor* (1886) 33 Ch.D. 528; *Pickering v. Stephenson* (1872) L.R. 14 Eq. 322; *Cullerne v. London and Suburban General Permanent Building Society* (1890) 25 Q.B.D. 485; *Burland v. Earle* [1902] A.C. 83; *Yorkshire Miners' Association v. Howden* [1905] A.C. 256, 263 and *Taylor v. National Union of Mineworkers (Derbyshire Area)* [1985] B.C.L.C. 237, 241, 246, 247, 254, 255.]

An individual shareholder has locus standi to bring proceedings on behalf of the company, to recover assets, where there has been misappropriation, or an ultra vires transaction, and not merely a right to seek an injunction to restrain such matters.

[At this point on 14 November the plaintiff sought leave to appeal on the ruling given as to procedure. Knox J. refused leave, and the case was then adjourned for an application for leave to be made to the Court of Appeal. The Court of Appeal refused leave and the hearing was resumed on 17 November.]

Potts Q.C. continuing. The rule in *Foss v. Harbottle,* 2 Hare 461 does not prevent an individual shareholder from seeking an order for repayment and has no impact where the claim is based on ultra vires. The board cannot release a claim maintained by an individual shareholder for repayment to the company. A valid release could only be made by way of special resolution at a general meeting of the company: *Buckley on the Companies Acts,* 14th ed. (1981), vol. 1, p. 988. [Reference was made to *Yorkshire Miners' Association v. Howden* [1905] A.C. 256, 263; *Dominion Cotton Mills v. Amyot* [1912] A.C. 546 and *Pickering v. Stephenson,* L.R. 14 Eq. 322.]

Two quite separate principles exist: in the case of ultra vires transactions, the question who is in control is irrelevant; but in the case of fraud on a minority it is clearly very relevant. In the former case release is impossible. The argument that directors can release any cause of action could logically apply just as well to prospective transactions, as to past ones. [Reference was made to *Towers v. African Tug Co.* [1904] 2 Ch. 558, 564, 566, 567, 569; *Baillie v. Oriental Telephone and Electric Co. Ltd.* [1915] 1 Ch. 503, 510, 511, 518; *Cotter v. National Union of Seamen* [1929] 2 Ch. 58, 67–70, 72, 86, 99, 100, 107, 110; *Edwards v. Halliwell* [1950] 2 All E.R. 1064; *Pavlides v. Jensen* [1956] Ch. 565, 567, 568, 572–574; *Birch v. Sullivan* [1957] 1 W.L.R. 1247, 1250; *Heyting v. Dupont* [1963] 1 W.L.R. 1192 and [1964] 1 W.L.R. 843 and *Australian Coal & Shale Employees' Federation v. Smith* (1937) 38 S.R.(N.S.W.) 48, 53–57, 60.]

In *Wallersteiner v. Moir (No. 2)* [1975] Q.B. 373, 390 there was no suggestion whatever that there was any need for a secondary counting of heads amongst the independent shareholders. [Reference was made to *Daniels v. Daniels* [1978] Ch. 406; *Estmanco (Kilner House) Ltd. v. Greater London Council* [1982] 1 W.L.R. 2, 15, 16; *Devlin v. Slough Estates Ltd.* [1983] B.C.L.C. 497, 502, 503 and *Viscount of the Royal Court of Jersey v. Shelton* [1986] 1 W.L.R. 985.]

In English law any provision purporting to release a director from his obligations would be void. Criticism of Vinelott J.'s judgment in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982]

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Ch. 204 presupposes that the facts alleged by the plaintiffs in that case fall within the exception to the rule in *Foss v. Harbottle,* 2 Hare 461 based on fraud on a minority. That was the only issue on which they could have been relying and on that point—a preliminary issue would have been within a small company, since there was no control by the wrongdoers. If a writ had not already been issued and some shareholders wished to stop the proceedings they would have to show that the company had no cause of action. The company in general meeting would require a special resolution to overrule the board's decision not to issue. The question of release is irrelevant in the context of ultra vires.

In re Hellenic & General Trust Ltd. [1976] 1 W.L.R. 123 provides a common sense test; a meeting of the class affected was required to "enable them to consult together." By analogy the shareholders of Wren Trust Ltd. should be allowed to consult together, to clarify the company's position, and establish their independence or otherwise. [Reference was made to *Buckley on the Companies Acts*, 14th ed., vol. 1, p. 199. *Mason v. Harris* (1879) 1 Ch.D. 97, 107, 109; *Gower, Modern Company Law,* 4th ed. (1979), p. 653 (footnotes).]

The sole question for the court is whether the plaintiff has sufficiently demonstrated that he can put the company in motion; the idea of a "counting of heads" amongst the minority is specifically reflected in *Russell v. Wakefield Waterworks Co.,* L.R. 20 Eq. 474, 482. [Reference was made to articles by Wedderburn on "Shareholders' Rights and the rule in Foss v. Harbottle." [1957] C.L.J. 194 and [1958] C.L.J. 93; *In re Halt Garage (1964) Ltd.* [1982] 3 All E.R. 1016, 1023, 1028, 1032.] In the present case the payments to the directors were not made under board resolution, a purported resolution, and no services were rendered by the associated companies.

The payments have not even been characterised in the accounts as being "remuneration." Only actual liabilities should count for the purpose of testing the propriety of the payments. The payments to associated companies appear to constitute "sham" payments. *In re Lee, Behrens & Co. Ltd.* [1932] 2 Ch. 46, where a pension granted to the widow of a company director was held to be void, and the widow was not entitled to prove for it in a winding up, is a useful guide in considering whether something is a breach of a director's fiduciary duty or is a proper exercise of fiduciary power. The transactions complained of, or some of them, had the effect of reducing the company's net assets, by giving financial assistance in the purchase of its own shares, in contravention of section 42 of the Companies Act 1981. [Reference was made to section 87(4)(*c*) of the Companies Act 1980.] Breach of section 42 is a criminal offence; it cannot be described as a 'technicality.' The 1982 accounts were not even in existence at the time the payments complained of were made. These transactions are pivotal to this case since it was only by their means that the directors gained "control." As a matter of law directors cannot act informally. The court cannot presume that "unlabelled" payments to directors were by way of remuneration for services. It is clear that the fourth defendant was a party to the transactions complained of. It is also clear that Wren Trust Ltd. participated. Prima facie they were not "disinterested." On the

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footing of establishing a prima facie case, the proceedings are in a "shambles," because if the burden of proof rests upon a party, that party should be entitled to address the court first.

Aldous Q.C. in reply on the main case. The question whether there was a contractual obligation to make the payments does not arise, because they were clearly made to the associated companies for their services; the issue is whether the payments made were fair and reasonable for the work done. It is a familiar practice for companies to be paid for services rendered by individual directors. There was a power to pay any level of remuneration, and when paid out of divisible profits, any level of remuneration is capable of being authorised. [Reference was made to *In re George Newman & Co.* [1895] 1 Ch. 674 and *In re Duomatic Ltd.* [1969] 2 Ch. 365; *North-West Transportation Co. Ltd. v. Beatty* (1887) 12 App.Cas. 589 and *In re Hellenic & General Trust Ltd.* [1976] 1 W.L.R. 123.]

In so far as the question is one of law, it is desirable that it should be decided, since it is unlikely to arise at trial, and it may dispose of the proceedings, if it is decided in the defendant's favour. The point of law does not depend on disputed facts. The case proceeds on the basis of whether a prima facie case is shown. Reliance is placed on *Williams Humbert Ltd. v. W. & H. Trade Marks (Jersey) Ltd.* [1986] A.C. 368. Confusion has been caused by the 19th century cases, because many of them were decided on demurrer, because some of them combined personal and derivative claims in the same action, and because in some cases analogies were drawn with the law on partnerships or trusts or on trade unions. The company itself is capable of ratifying or compromising the claim or effectively resolving not to sue, so as to bind all shareholders: there is no reason why it should not be able to stop proceedings brought on its behalf of majority shareholders, who can be in no better position than the company itself. Potts Q.C. contends that the minority shareholder has a personal right to sue on the company's behalf, once he has established the company is in the control of the wrongdoers! [Reference was made to *Gower, Modern Company Law,* 4th ed. (1979), p. 651, para. (iii).]

It is said that even if the board is independent, and 99 per cent. of the shares were to be held by "outsiders," the remaining one per cent. could bring a derivative action; if that were so it would have far reaching consequences, since it would enable a trade rival to buy single share in order to maintain a derivative action for wholly improper reasons. The Court of Appeal in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204 clearly contemplated that the views of independent shareholders should be consulted: see [1981] Ch. 323 *per* Vinelott J. [Reference was made to *Burland v. Earle* [1902] A.C. 83; *Sinclair v. Brougham* [1914] A.C. 398, 414, to 418, 433, 440, 452; *Palmer's Company Law,* 23rd ed. (1982) p. 848; *Buckley on the Companies Acts,* 14th ed., vol. 1, pp. 898, 992; *Hogg v. Cramphorn Ltd.* [1967] Ch. 254; *Bamford v. Bamford* [1970] Ch. 212; *Gower, Modern Company Law,* 4th ed., pp. 147, 148, 643 and *Wallersteiner v. Moir (No. 2)* [1975] Q.B. 373; 404.]

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A It does not follow that because a derivative action is not demurrable that the plaintiff can maintain it; it may still be an abuse of process, where the claim has in fact been released. The statement of claim might appear sound on its face, but the objections arising from the split nature of the claim, between "personal" and "derivative," might only come to the surface on the defence. [Reference was made to *Taylor v. National Union of Mineworkers (Derbyshire Area)* [1985] B.C.L.C. 237, 241–245.]
B In demurrer cases, the claim will be struck out where the complaint is ratifiable. [Reference was made to *Mozley v. Alston* (1847) 1 Ph. 790; *Lord v. Governor and Company of Copper Miners* (1848) 2 Ph. 740; *Bagshaw v. Eastern Union Railway Co.* (1849) 7 Hare 114; *Salomons v. Laing* (1850) 12 Beav. 377; *Clinch v. Financial Corporation* (1868) L.R. 5 Eq. 450; *Gray v. Lewis,* L.R. 8 Eq. 526; L.R. 8 Ch.App. 1035;
C *Russell v. Wakefield Waterworks Co.,* L.R. 20 Eq. 474; *Atwool v. Merryweather* (1867) L.R. 5 Eq. 464n: *Simpson v. Westminster Palace Hotel Co.* (1860) 8 H.L.Cas. 712; *Davidson v. Tulloch* (1860) 3 Macq. 783; *Orr v. Glasgow, Airdrie and Monklands Junction Railway Co.* (1860) 3 Macq. 799; *Gregory v. Patchett* (1864) 33 Beav. 595; *Pickering v. Stephenson* (1872) L.R. 14 Eq. 322; *Hoole v. Great Western Railway Co.* (1867) L.R. 3 Ch.App. 262; *MacDougall v. Gardiner,* L.R. 20 Eq.
D 383; *Mason v. Harris,* 11 Ch.D. 97; *Cullerne v. London and Suburban General Permanent Building Society,* 25 Q.B.D. 485; *Yorkshire Miners Association v. Howden* [1905] A.C. 256; *Dominion Cotton Mills Co. Ltd. v. Amyot* [1912] A.C. 546: *Burt v. British Nation Life Assurance Association* (1855) 4 De G. & J. 158: *Towers v. African Tug Co.* [1904] 1 Ch. 558 and *Baillie v. Oriental Telephone and Electric Co. Ltd.* [1915]
E 1 Ch. 503.] *Cotter v. National Union of Seamen* [1929] 2 Ch. 58; *Edwards v. Halliwell* [1950] 2 All E.R. 1064; *Pavlides v. Jensen* [1956] Ch. 565; *Birch v. Sullivan* [1957] 1 W.L.R. 1247; *Heyting v. Dupont* [1964] 1 W.L.R. 843 and *Daniels v. Daniels* [1978] Ch. 406) *Turquand v. Marshall* (1869) L.R. 4 Ch.App. 326.]

To sum up: (i) None of the payments were in fact ultra vires in the true sense, since they fell within the provisions of paragraph 3 of the
F memorandum of association; (ii) None of the payments were in breach of duty, and all of them should be regarded as being made for individual services rendered by the directors; (iii) None were unreasonable in amount, and all were approved by all directors; (iv) Save for relatively small amounts they were disclosed in the company's accounts, and were approved by the shareholders; (v) There is no evidence to impugn the
G votes cast, since third parties, including Wren Trust, voted in favour; (vi) There was no breach of section 42 of the Companies Act 1981; all payments were subsequently included in the accounts as being for directors' services, and were ratified in general meeting by the shareholders. The payments were in line with the emoluments paid in previous and subsequent years. There is no ground for any allegations of fraud. It would be wrong to allow the action to proceed.

H *Oliver Q.C.* in reply. The arguments advanced by Mr. Aldous are adopted. It is not only desirable, but important that the court should decide the points of law arising. [Reference was made to *Russian Commercial and Industrial Bank v. Comptoir D'Escompte de Mulhouse*

[1925] A.C. 112, and *Banco de Bilbao v. Sancha* [1938] 2 K.B. 176.] Where the court embarks on a prolonged and thorough examination of facts and law cross examination and discovery could be ordered if appropriate. [Reference was made to *Pickering v. Stephenson,* L.R. 14 Eq. 322 and *Peel v. London and North Western Railway Co.* [1907] 1 Ch. 5, 11, 12, 20.] Cases in the 19th century tend to confuse ultra vires with breach of trust. There is no case which decides that where the majority of independent shareholders oppose the action it should be allowed to continue, and the reverse is suggested by *Taylor v. National Union of Mineworkers (Derbyshire Area)* [1985] B.C.L.C. 237. The opposite is consistent with common sense and principle. The question as to what to do after an ultra vires act has been committed is one of internal management, not of ratification. Every shareholder should be regarded as independent unless at the meeting at which his vote was exercised, there was reason to regard it as tainted. The precise ambit of the principle is not clear; a personal interest does not disqualify, but there is a duty to vote bona fide for the benefit of the company as a whole. [Reference was made to *Lindley on Partnership,* 15th ed. (1984), 478.] There is an overriding duty to consider the views of the minority and the power of the majority to bind them is based on bona fides. [Reference was made to *Menier v. Hooper's Telegraph Works* (1874) L.R. 9 Ch.App. 350, 353, 354; *Pender v. Lushington* (1877) 6 Ch.D. 70, 75, 76; *North-West Transportation Co. Ltd. v. Beatty* (1887) 12 App.Cas. 589, 593, 594; *Wall v. London and Northern Assets Corporation* [1898] 2 Ch. 469, 474, 480; *Allen v. Gold Reefs of West Africa Ltd.* [1900] 1 Ch. 656, 667, 670, 678, 679; *Brown v. British Abrasive Wheel Co. Ltd.* [1919] 1 Ch. 290, 295; *Sidebottom v. Kershaw, Leese & Co. Ltd.* [1920] 1 Ch. 154, 170; *Shuttleworth v. Cox Brothers & Co. (Maidenhead) Ltd.* [1927] 2 K.B. 9, 18; *Greenhalgh v. Arderne Cinemas Ltd.* [1951] Ch. 286; *Clemens v. Clemens Bros. Ltd.* [1976] 2 All E.R. 268 and *Estmanco (Kilner House) Ltd. v. Greater London Council* [1982] 1 W.L.R. 2.] It is clear that the exercise of votes is subject to equitable considerations, not confined to special resolutions; a personal interest does not disqualify a shareholder from voting. The court tolerates a conflict of interest up to a certain degree; the boundaries are essentially evidential. It does appear that where the defendants cast votes against proceedings where a prima facie case exists, a presumption is raised against the votes having been properly cast, i.e. that the court will not tolerate them. Beyond that in each case the court will look for credible evidence as to the motives for voting. The mere fact the votes were cast against proceedings does not vitiate them unless the shareholders' motives were unreasonable. Nor is it necessarily fatal that a person who is not a defendant and who votes against proceedings may have some association with the defendants, other than as a shareholder, but in such a case the court will be conscious of the possibility of conflict and will embark on an investigation as to his motives. In so far as the test propounded by Mr. Potts, citing *In re Hellenic & General Trust Ltd.* [1976] 1 W.L.R. 123, deviates from the test described above it is inappropriate. If fraud was to be pleaded it should have been pleaded with the highest degree of particularity.

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A *Potts Q.C.* in rejoinder on cases cited, Neither *Hogg v. Cramphorn Ltd.* [1967] Ch. 254, nor *Bamford v. Bamford* [1970] Ch. 212 was concerned with fraud on a minority. Breach of duty is not the same as fraud on a minority.

19 December. KNOX J. read the following judgment. I have before B me two notices of motion. The first is on behalf of the ninth defendant for an order pursuant to R.S.C., Ord. 18, r. 19, or under the inherent jurisdiction of the court that this action be struck out as being frivolous or vexatious or an abuse of the process of the court on the grounds that being purportedly brought by the plaintiffs on behalf of the ninth defendant the plaintiffs are in fact not entitled to bring or continue the same. The second is on behalf of the fourth defendant for an order in C similar terms, with an alternative ground, "alternatively that [the action] is obviously unsustainable against the fourth defendant." I have earlier ruled that the procedure thus adopted is not so defective that the application should in any event fail.

In the course of giving that ruling I expressed the view that the task for the court was to seek to follow the guidance given by the Court of D Appeal in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204, 221, where the following passage from the judgment of the court appears:

> "In our view, whatever may be the properly defined boundaries of the exception to [the rule in *Foss v. Harbottle* (1843) 2 Hare 461] the plaintiff ought at least to be required before proceeding with his action to establish a prima facie case (i) that the company is entitled E to the relief claimed, and (ii) that the action falls within the proper boundaries of the exception to the rule in *Foss v. Harbottle.*"

That I now proceed to attempt to assess.

Much of the factual background to these proceedings is not in issue and the dispute is far more concerned with the mental element in what F was done and the manner in which it was done than with what happened.

The present voting position among the single class of ordinary shareholders is as follows. The three plaintiffs, Nora Smith, Lucienne Crane and Lord Rathcavan, are the holders of 13,400, 1,000 and 4,000 shares respectively in the ninth defendant, Film Finances Ltd. ("the company") out of the issued share capital of 155,100 fully paid shares. G Together they therefore hold 18,400 shares which is 11·86 per cent. of the voting rights. The defendants against whom claims are made in the statement of claim are between them the holders of 97,000 shares, i.e. 62·54 per cent. of the voting rights. These defendants fall into three groups. The first, second and third defendants, William Alan Croft, Richard Martin Francis Soames and David Alexander Korda ("the H executive directors"), form one group. It is against them primarily that charges are brought. The fifth, sixth, seventh and eighth defendants, Mannergrand Services Ltd. ("Mannergrand"), Cushingham Ltd. ("Cushingham"), Bellwedge Ltd. ("Bellwedge") and Brindeel Ltd. ("Brindeel"), form the second group. I shall refer to them together as "the associated

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companies." They are controlled or closely associated with one or more of the executive directors, Mannergrand with Mr. Croft, Cushingham with Mr. Soames, Bellwedge with Mr. Korda and Brindeel with all three of the executive directors. Finally there is the fourth defendant, Michael Lewis Carr. He is the chairman and a non-executive director of the company. He is a director of Wren Trust Ltd. and nominated by it to the board of the company. That leaves 39,700 shares unaccounted for which fall into the following groups:

(i) 4,000 are held by Messel Nominees Ltd., a company whose shares are owned by another company, Defester Ltd., the shares in which are owned by Stephen Richard Hill and Peter Welsford, both of whom have been active in promoting the plaintiffs' claims. The votes attached to these shares are clearly in the plaintiffs' camp, bringing up their voting strength to 22,400 or 14·44 per cent. of the whole.

(ii) Two other shareholders, Georgian Investments Ltd., who hold 2,000 shares, and Sir Reginald Sheffield, who owns 50 shares, are not under the control of or closely associated with the defendants against whom claims are made and have unequivocally stated their opposition to the further prosecution of this action. They account for 1·32 per cent. of the voting rights.

(iii) Film Finances Pension Fund holds 2,950 shares or 1·9 per cent. of the voting rights. It is common ground that it is under the control of Mr. Soames and Mr. Korda and is to be treated for present purposes as on a par with the executive directors so far as voting is concerned.

(iv) Wren Trust Ltd. ("Wren Trust") holds 30,500 shares, i.e. 19·66 per cent. of the votes in the company. This company is a wholly owned subsidiary of Gresham Trust Plc., which is a member of the Eagle Star Group of companies. Wren Trust is thus owned and controlled by a large outside financial institution. One of the issues canvassed before me has been whether it should be regarded for the purposes of this application as independent or disinterested so far as the question whether or not these proceedings should continue is concerned. The boards of Wren Trust and of Gresham Trust Plc. have both expressed the view that the proceedings should not continue.

(v) Finally there are two holders of 100 shares each who have not committed themselves. This shareholding is so small as not to be of practical significance.

The following conclusions can be drawn from these shareholdings: (1) The executive directors with the associated companies have overall voting control. (2) If one excludes the votes of the executive directors, the associated companies and Film Finances Pension Fund, then the votes of Georgian Investments Ltd., Sir Reginald Sheffield and Wren Trust totalling 32,550 (or almost 20·99 per cent. of the whole) comfortably exceed those of the plaintiffs and the Messel Nominees, totalling 22,400 (14·44 per cent. of the whole) but not so comfortably as to give a 75 per cent. majority of the votes excluding those mentioned above. The majority is in fact about 59·24 per cent. Such a majority can carry an ordinary but not a special resolution. (3) If the votes of Wren Trust are excluded as well as those of the executive directors, the associated companies and Film Finance Pensions Fund, then the plaintiffs

A and Messel Nominees with 22,400 votes have a very large majority over Georgian Investments Ltd. and Sir Reginald Sheffield, with 2,050 votes. That majority would be one of 91·62 per cent. and sufficient to pass either an ordinary or a special resolution.

The factual background is as follows. It will be appreciated that I am not making findings of fact at the end of an action and I am therefore limiting this account of the facts to that which seems to me necessary to B explain the reason for my decision on the questions I have to answer and which appear from the quotation at the outset of this judgment from the Court of Appeal decision in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204.

The company was incorporated on 24 February 1950 with an initial paid up capital of £7,500. Throughout its history its trade has been the C unusual one (it appears its only significant competitors are overseas companies) of guaranteeing the completion of films on time and within budget. It is obvious that this is a specialised business requiring for its successful operation both wide contacts in the film making world and skill and experience in the production of films. It is also a business which requires a very small number of highly skilled personnel. The number of executives has not exceeded ten. It is the absolute antithesis D of mass production.

The founder of the business retired in 1959, and Robert Garrett became chairman and managing director. He had for a number of years a joint managing director, Bernard Smith, who died in 1977. The first plaintiff is his widow. Mr. Soames, the second defendant, joined the company as an employee in 1971, became a director in 1975 and E managing director in 1977 in place of Bernard Smith and Robert Garrett, who continued as chairman. Mr. Croft, the first defendant, has been a director since well before October 1979. He is a chartered accountant and deals with the financial side of the business such as investments. This is very important more especially as it is from the income from premiums received by the company and invested that its profit is largely derived. In this it resembles many insurance companies F which suffer underwriting losses but remain profitable because of their invested income. A Mr. Aikin, a solicitor, became an executive director in 1978 but resigned in September 1981 and Mr. Carr, the fourth defendant, was appointed director in October 1979 as the nominee of Wren Trust. Mr. Korda, the third defendant, became an executive director in July 1981. He ceased to be an executive director in January G 1985 when he became managing director of R.K.O. Film Group International at a very large salary but remained a non-executive director of the company. So from October 1979 until October 1982 Mr. Garrett was chairman, the directors who were executives were Mr. Croft, Mr. Soames and Mr. Aikin or Mr. Korda, there being a short period in 1981 when both were on the board, and Mr. Carr was a non-executive director.

H At the beginning of 1982 the executive directors only had shares carrying about 20 per cent. of the voting rights and the associated companies had none, but Mr. Aikin who had resigned by September 1981 had 7·5 per cent. of the voting rights. During the course of 1982

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the executive directors and the associated companies acquired enough shares to give them, together with Wren Trust, overall voting control. Those acquisitions include transactions which the plaintiffs seek to impeach in these proceedings as having been effected by means of financial assistance from the company in breach of section 42 of the Companies Act 1981. Specifically Bellwedge bought 2,400 shares, Mannergrand bought 3,050 shares, as did Cushingham, and Brindeel bought 19,900. Bellwedge's purchase is not challenged in the statement of claim while those of Mannergrand, Cushingham and Brindeel are, but it was the latter that Mr. Potts, for the plaintiffs, placed in the forefront of his argument on section 42 of the Companies Act 1981.

The purchase of 19,900 shares by Brindeel with money borrowed from the bank, the fact that Brindeel was acquired by the executive directors on or about 11 June 1982 with a view to the purchase of the 19,900 shares, that each of Mannergrand, Cushingham and Bellwedge received £33,000 from the company in early August and lent £28,000 to Brindeel thereafter, and that these sums were used by Brindeel to discharge its bank indebtedness are all admitted. What is denied is that the payments by the company to those three associated companies constituted financial assistance within section 42(2) of the Companies Act 1981. The defendants contend that these payments were in satisfaction of anticipated liabilities by way of salary or bonus payable to the executive directors and that on that basis there was no reduction of the net assets of the company for the purposes of section 42(2). I shall return to this later.

By 1982 there had been dissension for some time on the board of the company between Mr. Garrett, the chairman, who had been involved with the company from very early days and who was by then 70 years or so old, and the executive directors who were younger and had adopted a policy of expanding the company's business overseas, a project to which Mr. Garrett was opposed. Matters came to a head in 1982, when the executive directors had completed their share purchases, which were not revealed in advance to Mr. Garrett, and Mr. Garrett was forced to resign as a director in October 1982 and received a £60,000 ex gratia payment. This caused a good deal of bitterness. One consequence was that Mr. Garrett consulted Mr. Hill to advise him about the executive directors' and Mr. Carr's activities, and Mr. Garrett provided Mr. Hill with a good deal of documentary material from the company's offices. This continued after Mr. Garrett's departure through Mr. Garrett's secretary, a Mrs. Byford, who clearly disapproved of the way Mr. Garrett was forced to resign and who continued, unbeknown to the executive directors for some time to provide Mr. Hill with documentary material from the company's offices.

Armed with this material Mr. Hill launched a sustained campaign of criticism of the conduct of the affairs of the company by the executive directors, and Mr. Carr in particular, at the amounts drawn out of the company by the executive directors and the associated companies. Here again there is no dispute about the amounts drawn out. I ignore sickness benefits, pension scheme payments and small fixed directors' fees. In other respects payments were made as follows:

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A

	1980	1981	1982	1983	1984
Mr. Soames:	£	£	£	£	£
Salary	42,000	50,000	53,333	67,500	70,000
Bonus	29,800	40,000	40,000	70,000	100,000
Cushingham Ltd.	15,000	18,500	61,000	—	—
Mr. Croft:					
Salary	8,500	15,000	15,000	—	—
Bonus	24,300	20,600	10,000	—	—
(Connected Companies)					
Billsons & Co.	5,650	15,150	15,150	15,150	55,150
Mannergrand Services Ltd.	7,500	27,500	29,000	50,000	30,000
Mr. Korda:					
Salary	—	8,751	—	—	—
Bonus	—	—	—	—	—
Bellwedge Ltd.	—	—	76,169	93,750	131,867
Mr. Garrett:					
Salary	21,000	25,000	25,000	8,333	—
Bonus	51,000	70,750	—	—	—

B

C

D

The ex gratia payment of £60,000 mentioned above was also paid to him. Mr. Aikin's payments I need not detail. Finally in relation to Mr. Carr, there were payments of £1,500 made to Gresham Trust Plc. in the years 1980, 1981 and 1982 and £7,595 in 1983 and £5,028 in 1984.

Before the annual general meeting of the company called for 10 December 1982 Mr. Hill's solicitors wrote a letter dated 7 December 1982 to Mr. Carr:

E

"Strictly private and confidential. Re: Film Finances Ltd. We are writing to you in your capacity as chairman and nominee of a minority shareholder in the above company. We are instructed by Mr. S. R. Hill, F.C.A., who has been appointed to act as adviser to a number of minority shareholders in the company holding in total over 40 per cent. of the issued share capital, including the executors of Patrick Garrett for whom we also act.

F

"We understand that Mr. Hill informed you last week that: (1) The 1982 published accounts of the company are grossly misleading, indicating as they do a profit before tax of over £500,000 whereas compliance with current accounting standards and the usual statutory requirements would result in showing a loss of over £500,000. (2) The amounts proposed in the accounts as directors' remuneration are excessive, unreasonable and so out of all proportion as to cause very considerable doubt as to the collective bona fides of the executive directors. (3) There is firm evidence that the managing director of the company earlier this year approached a merchant bank (not your own of course) to seek advice on how to employ the company's funds to enable the executive directors to obtain 100 per cent. control of the company. It would appear that the advice given was based upon an incomplete explanation of the provisions of sections 42 to 44 of the Companies Act 1981, which sections also

G

H

impose criminal penalties for failure to comply with their provisions. A

"We understand that Mr. Hill did not inform you of this aspect of item (3) above as he would have preferred to have told you this in person and shown to you the evidence. However, Mr. Hill did inform you that there is evidence that the executive directors have partially adopted this misleading advice in the current year, in that there are accounting irregularities in respect of items passing through the bank pass sheets not entered in the cash book of the company. B (Mr. Hill, of course, only has detailed information up to mid-October when Mr. Garrett retired from chairmanship of the company.) In view of the prima facie evidence of fraud, the minority shareholders' group requires that further investigations be carried out to enable this evidence to be substantiated or refuted and the available remedies pursued if necessary. It would be C preferable that you use your position as chairman of the company to effect this, as the alternatives would be a Department of Industry or fraud squad investigation which could result in very far-reaching consequences including exposure damaging to the company. (4) There is evidence of other financial irregularities that are not of such pressing importance as points (1) to (3) above and which may be regulated in due course following the full and early investigation D that must be carried out into the affairs of the company. . . ."

At the annual general meeting of the company on 10 December 1982 at which the accounts for the year ending 30 June 1982, approved by the directors on 18 November 1982, were to be laid for approval, there were angry scenes and allegations of accounts incorrect by £1 million. Mr. E Carr adjourned the meeting and forthwith instructed Messrs. Peat, Marwick Mitchell & Co. to investigate and report upon Mr. Hill's complaints. Initial instructions were by telephone but the formal instruction was in a letter from Mr. Soames dated 14 December 1982. It is addressed to Peat, Marwick Mitchell & Co. for the attention of Tom Allen, Esq. and reads:

F

"Dear Sirs, I write to confirm the board's instructions to you to carry out an investigation of the affairs of this company in respect of its accounting period to 30 June 1982, the following period and any preceding period or periods you may think necessary in relation to the allegations set out in points (1) to (4) inclusive of the letter from Wood Nash & Winters dated 7 December 1982 addressed to Michael Carr."—That letter is the one which I have just read.—"In G view of the seriousness of the allegations you are requested to commence and complete the investigation as soon as possible and make a full report to the board at the earliest possible date.

"While the board's instructions are to investigate specific points referred to, it is not their intention to prevent or restrict you from extending the investigation where you believe it to be necessary in the cause of establishing the truth or in the event that other H irregularities are revealed.

"I confirm that instructions have been given to all the executives and employees of the company and to its solicitors and auditors to

A co-operate with you to the fullest extent and to give you such information as you may require."

That is signed on behalf of Film Finances Ltd. by Mr. Soames.

Mr. Allen of Peat, Marwick Mitchell & Co. interviewed the company's staff and directors, met Mr. Hill and his helper Mr. Welsford twice, and had access to the company's books. His report ("the report") B was produced on 11 March 1983. It contains the following passage, after having set out the circumstances of the investigation being instituted:

"We have decided that it would be appropriate for us to submit a report at this stage, which addresses the matters set out above and summarises our comments in relation to the work we have so far carried out. The directors will then be in a position, having C considered this report and received any representations which shareholders think fit to make to them, to consider whether or not we should be asked to pursue any of the matters discussed, or any other matters."

The report is therefore not to be regarded as necessarily definitive. A substantial part of the report was concerned with criticisms made by Mr. D Hill and set out in his solicitor's letter of 7 December 1982, which I have read, concerning the accountancy deficiencies in the preparation of the company's accounts. These criticisms were effectively rejected in the report. No claims are made in this action about this and I pass over that part of the report. [His Lordship read part of the report, headed "Directors remuneration and allied matters" and continued:] Then there are set out in tabular form figures for emoluments and payments to E connected firms or companies which correspond, so far as the figures are concerned, with the figures in the statement of claim.

Two things appear from the extract of the report quoted above. The first is that it was Mr. Allen's view that the payments to Cushingham in the years ending 30 June 1980, 1981, 1982 of £15,000, £18,500 and £61,000 should have been disclosed as part of Mr. Soames' emoluments F because in the circumstances they did fall within the requirements of section 196 of the Companies Act 1948. The inclusion in the note on directors' salaries of the £61,000 for 1982 in the revised 1982 accounts which were presented to and passed by the adjourned annual general meeting on 30 March 1983 and the inclusion therein of the £18,500 for 1981 in the comparative figures in those accounts constitute a major difference between those accounts and the original 1982 accounts which G were approved by the directors on 18 November 1982 and laid or intended to be laid before the annual general meeting on 10 December 1982.

The second is that if the only basis upon which the payments to Mannergrand or Billsons and Bellwedge could be justified was that of remuneration for acting as a director or in connection with the management of the affairs of the company the same conclusion as that H reached regarding Cushingham would have applied. But Mr. Allen took the view that these payments were for services rendered by the organisations to which payments were made and were exempt from disclosure under section 196 of the Companies Act 1948 because the

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services could have been provided whether or not Mr. Croft and Mr. Korda had been directors of the company. In relation to Mr. Korda there is a later reference in the report to "the technicality that Mr. Korda works for Bellwedge Ltd. which provides his services to the company." The amounts involved are not limited to those mentioned for the year ending 30 June 1982 with which the report was primarily concerned but also so far as Mr. Croft is concerned £13,150 and £42,650 for the years ending 30 June 1981 and 1982.

The report went on to deal with some matters which I need not discuss because they are not in issue in this action, such as Mr. Carr's consultancy fees paid to Gresham Trust Plc., the taxation treatment of directors' emoluments, the relevance of dividend waivers and continued:

> "Mr. Carr, who became chairman of the company in October 1982, was previously a non-executive director and is now non-executive chairman. Mr. Soames and Mr. Korda are both engaged full time in working for the company (ignoring the technicality that Mr. Korda works for Bellwedge Ltd. which provides his services to the company). Mr. Croft is in practice as a chartered accountant, but spends at least two full days a week at the company's offices and we understand that he is available to the company at all times for such other time as is needed.
>
> "The company operates in an industry where the risks and rewards are high. The levels of remuneration, and standards of living, enjoyed by prominent people in the industry are often high in relation to those enjoyed by prominent people in many other industries. In their business relationships with companies in the industry, the directors are dealing with prominent people in the companies concerned.
>
> "It has been indicated to us that the time devoted by Mr. Garrett to the affairs of the company in recent years was substantially less than full time. However, Mr. Garrett had, in the past, been active in the company's affairs and continued to be identified with the company as a prominent member of the industry.
>
> "In forming a view as to whether the level of emoluments and charges paid or payable to the directors and/or the connected companies is reasonable, there are no absolute yardsticks and, while members will no doubt want to form their own views they may wish to have regard to our general comments, as set out above.
>
> "The arrangements for the determination of the levels of remuneration, and the acceptance of charges from connected companies, would appear to have been conducted with very little formality. We understand that the present directors do not have service agreements. Mr. Garrett had a service agreement which was not due to expire until 31 March 1985; this was terminated on his resignation in October 1982. As a consequence of the termination of his service contract, the company made an ex gratia payment of £60,000 to Mr. Garrett and agreed to indemnify him against liabilities arising out of claims or proceedings brought against the company or himself relating to the term of his employment

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A (excluding liability for taxes for which Mr. Garrett might be personally assessable).

"There is some reference in the minutes to agreed salary levels, but a substantial part of the total remuneration has been by way of bonus and, for the most part, it is not possible to point to specific memoranda or minutes of directors' meetings confirming the levels of remuneration and charges from connected companies.

B "The view has probably been taken that, because of the very few people involved, the frequent overseas travel which is necessary (making formal meetings difficult to arrange) and the ability of the directors to deal with matters on an informal basis, there is no need for formal confirmation of matters discussed informally between the directors. In any event, it can be argued that the approval of the C company's accounts by the directors for submission to members constitutes implicit approval of all the amounts included in the accounts. This is not, however, a company in which all the shares are owned by the directors, nor is it a company in which all the directors have been, or have remained, in agreement with one another. In our view it is most important that there should be a proper record of directors' meetings and confirmation of approval D by the directors of their remuneration, amounts payable to companies with which they are connected and other significant matters. We do not think that the lack of formal confirmations affects the validity of the charges accepted by the company but, not least in the directors' own interests, we strongly recommend that in future these matters should be properly recorded."

E Mr. Potts attacked the adequacy of the report, regarding payments thus dealt with, principally on the ground that Mr. Allen had failed entirely to address himself to the question of the characterisation of the disputed payments, and had not satisfied himself on the question whether there was or was not a contractual obligation on the company to the several associated companies, and whether the latter ever did actually render F any services to the company.

[His Lordship read part of the report dealing with the directors' expenses incurred in travelling and promoting the company, stated that, in relation to the impeached share transactions and the complaints made under section 42 of the Companies Act 1981, the report first of all set out the transfers in question, then stated that the transfers were G approved by a directors' meeting of 19 October 1982, that the payments for the three parcels of shares bought by Brindeel were made on 1 and 14 July and 7 September 1982 which was the date when the transfers were lodged for stamping with the Inland Revenue and that the approval of the accounts of the company, for submission to members by the directors, on 18 November 1982, effectively constituted implicit approval of all the items included in the accounts and the necessary formal H approval of various charges relating to the directors and connected companies might be said to be implicit in the approval by the directors of the accounts of the company. That part of the report also criticised the lack of formal procedures for the approval of expenditure but

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concluded that the question of whether the payments made in August 1982 were properly made by the company depended on whether or not the charges from the companies in question were proper charges for the company to accept. His Lordship continued:] The report does not in terms say that the charges made by the associated companies were proper charges. That was in a sense left for shareholders to make up their minds about in the light of the general considerations set out in the earlier passage in the report which I have already quoted.

Here too Mr. Potts criticised the report on the following grounds. The reliance on the accounts for the year ending 30 June 1982 was, he submitted, misplaced, because those accounts, even in the first edition, were not approved by the directors until 18 November 1982 and were therefore not in existence in August 1982 when the three cheques for £33,000 plus V.A.T. were signed in favour of the associated companies. Everything hinged, he submitted, on whether there was at that date an obligation to pay, a question which was assumed rather than decided in the report. So far as the executive directors were concerned the only liability of the company was under such service contracts as existed.

As to service contracts there is no dispute on the facts. Mr. Soames had a service agreement dated 27 May 1975 which by clause (4) provided for him to receive a fixed salary of £10,000 per annum with such bonuses as the directors might determine with a proviso that in no event should the said salary and bonus payable in any one year exceed £20,000. That agreement has not been terminated. Various resolutions have been passed by the board resolving that clause (4) of the service agreement should be varied by increasing Mr. Soames' salary to figures in excess of £20,000, or that his basic emoluments or salary should be increased to figures in excess of £20,000. With effect from 1 July 1980 the operative figure under the latest such resolution is £50,000. Mr. Korda too had a letter dated 15 April 1981 setting out the terms of his employment as a full-time executive of the company at a salary of £35,000 per annum. So far as Mr. Croft is concerned there was no formal service contract but there have from time to time been board resolutions increasing his salary. The amounts paid to the executive directors and the associated companies in respect of services rendered have at all material times exceeded the amounts provided for by the relevant service agreement or board resolution and the justification for this is claimed to reside in the board's powers under the articles, and if necessary that of the company in general meeting.

The relevant articles provide as follows. (I take the version exhibited to Mr. Croft's affidavit of 9 January 1986 as more up to date than that exhibited earlier by Mr. Hill. Only the numbering differs; the texts are the same so far as relevant.) Article 10 reads:

> "The first sentence of clause 76 of Part I of Table 'A' shall be deemed to be deleted. Each of the directors shall be paid out of the funds of the company by way of remuneration for his services as a director, at the rate of £150 per annum and the chairman shall also be paid additional remuneration for his services as chairman at the rate of £100 per annum. Such rates of remuneration may be increased by an ordinary resolution of the company."

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A Article 18 reads:

"(A) The directors may from time to time appoint one or more of their body to be holder of any executive office, including the office of chairman, deputy chairman, managing or joint managing director or manager, on such terms and for such period as they may determine. . . . (C) A director appointed to any such office as is B mentioned in sub-paragraph (A) of this article shall receive in addition to any remuneration to which he is or may become entitled under clause 76 of Part I of Table A hereof such additional remuneration by way of salary, lump sum, commission or participation in profits as the directors may determine, and he or his dependants may receive from the company such pension or other gratuity benefit or retiring allowance as the directors shall think fit."

C Article 76 of Table A provides:

"The remuneration of the directors shall from time to time be determined by the company in general meeting. Such remuneration shall be deemed to accrue from day to day. The directors may also be paid all travelling, hotel and other expenses properly incurred by D them in attending and returning from meetings of the directors or any committee of the directors or general meetings of the company or in connection with the business of the company."

I mention in passing that article 80 of Table A is not modified or excluded, and thus the business of the company is to be managed by the directors.

E Purely as a matter of construction it is in my judgment clear that the exclusion of the first sentence in article 76 of Table A contained in article 10 relates only to remuneration for activity as a director and does not operate to exclude the residual power of the company in general meeting to approve remuneration for executive services. Even on that basis, however, the actual right to remuneration, over and above what F any relevant service agreement provided in relation to services rendered in the year ending 30 June 1982, would not have arisen, on any view, before the directors' meeting approving the accounts for that year in October 1982, and therefore after August 1982 when the impeached payments to the associated companies were made. So if Mr. Potts is right in his submission that only actual liabilities counted for the purpose of testing the propriety of a payment by a company in relation to section G 42 of the Companies Act 1981, a breach of the section would be established at least prima facie. I shall return to this later.

Once the report was issued a revised version of the accounts for the year ending 30 June 1982 was prepared, and the annual general meeting, which had been adjourned on 10 December 1982 and once again later, was completed on 30 March 1983. At that meeting those accounts, as thus revised, were approved by a majority of the shareholders, but there H is no undisputed evidence of how the majority was made up. There were many criticisms voiced at that meeting, mainly by Mr. Hill. In general terms they were principally directed either at accounting questions concerning the calculation of profits or at the level of

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remuneration which the executive directors were receiving. There were also criticisms, not only from Mr. Hill, of the payment of £61,000 to Cushingham Ltd. and its treatment in the accounts and in the report. It is not, however, now claimed in the action that any of the matters now complained of, regarding the year ending 30 June 1982, were not, at least in general terms, matters of which the ordinary shareholders were made aware, through the report and the revised accounts for that year.

In the last two years in which there are payments which are impeached (the years ending 30 June 1983 and 1984) Mr. Soames received the whole of the payments made in connection with his services, and nothing was paid to Cushingham. On the other hand apart from the fixed director's fee of £150 and the relatively trivial payments for sickness insurance neither Mr. Croft nor Mr. Korda received salary or bonus, but Billsons and Mannergrand between them received £65,150 in the first of those years and £85,150 in the second, while Bellwedge received £93,750 and £131,867 in those years respectively. There is no allegation that these sums were not revealed in the company's accounts for those years, and those accounts were passed at an annual general meeting of the company, as regards one year, with one dissentient voice (that of a representative of Messel Nominees) and, as regards the other, without dissent.

During 1984 the company, in accordance with the relevant provision of the Companies Act 1981, purchased 44,900 issued shares, principally from members of the family of Mr. Garrett, who had died on Christmas Eve 1982, and the executive directors purchased other shareholdings from one or more of the vendors to the company totalling 12,350 shares at the same price of £9 per share. Other minority shareholders were offered the same price but, save for a Mr. Travis who sold 4,000 shares in July 1984 to Mr. Soames and Mr. Korda, again at £9 per share, no further shares changed hands, leaving the voting position as I described it at the outset.

Over the years while the executive directors have had control of the management of the company the trend both of profits, net assets and dividends have all followed a general upward course. In the year ending 30 June 1977 there was a loss before taxation of £237,257, net current assets of £6,439 and no dividend was declared, while for the year ending 30 June 1984 the accounts show group profit on ordinary activities before taxation of £1,244,185, net current assets of £4,090,518 and a dividend of £1·50 per share was declared. On any view the business has expanded and is very substantial. This has been reflected by the trend in the price paid for shares in the company, which has risen from £3 in early 1982 to £9 in 1984. The plaintiffs' complaint is that the profits should have been larger still, if the executive directors had behaved with the same commercial enthusiasm so far as the company's earnings are concerned, but with greater legal and accountancy propriety and honesty so far as payments out by the company are concerned.

The writ was issued on 7 February 1985 with the statement of claim endorsed upon it. The claims made in the very lengthy statement of claim can be placed in four categories.

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A (1) There are claims of excessive remuneration in the strict sense of excessive payments to the person direct who is alleged to be overpaid. For example, paragraph 32 of the statement of claim avers that Mr. Soames was paid £170,239 in respect of the year ending 30 June 1984 in addition to his fixed £150 under the articles, that these payments purported to be by way of salary and bonus, that it is not admitted that any of these sums were duly paid to him, save in so far as they were B authorised by his service agreement, and that at least to the extent to which £170,239 exceeded £93,543 (viz. what Mr. Soames was paid in the year ending 30 June 1982) that was in excess of a commercially fair, reasonable and proper remuneration. The conclusion is drawn that to the extent of not less than £76,696 there was an ultra vires gift by the company, that the executive directors and Mr. Carr, in procuring such C payments, did not act in good faith or for the benefit of the company, but with a view to benefiting Mr. Soames, were in breach of their fiduciary duties and guilty of a fraud upon the minority shareholders, that those breaches were dishonest and that the executive directors and Mr. Carr were guilty of a conspiracy in so acting.

(2) The second category of claims made relates to payments made to one or other of the associated companies or Billsons which are claimed D also to be in whole or in part payments not authorised by the board or otherwise and constituting an ultra vires gift by the company made otherwise than in good faith or for the benefit of the company but rather with a view to benefiting the executive director concerned and made in dishonest breach of fiduciary duties by way of fraud upon the minority shareholders and the product of conspiracy.

E I take as an example a claim to a sum of £55,300 referred to in paragraph 31(iii) of the statement of claim. In relation to that it is pleaded by paragraph 31(i) that in respect of the financial year ending 30 June 1984 the executive directors and Mr. Carr procured the payment out of the company's funds of £85,150 to Mannergrand and/or Billson, that none of those payments was authorised by the company either by virtue of any resolution of its board of directors or otherwise, and that F in relation to those payments to the extent of not less than £55,300 they were received by Mannergrand and/or Billson purportedly in respect of services allegedly rendered to the company by Mannergrand and/or Billson during that financial year but that in reality the company received no consideration or benefit of any kind for any of those payments to that extent but they amounted in substance to a gift out of the funds of G the company and were ultra vires the company. That figure of £55,300, which is the part of the total of £85,150 paid out to Mannergrand and Billson, and is claimed to be thus vitiated, is arrived at by deducting from the total payments of £85,150 £29,850, which is what Mr. Croft received from the company in respect of the financial year ended 30 June 1983 and with regard to which the plaintiffs, while not admitting that they ever became payable to Mr. Croft except to the extent that a H fixed salary was payable to Mr. Croft in accordance with the resolutions of the board, the last of which was for Mr. Croft's existing salary to be increased to £15,000 per annum, nevertheless do not raise a claim of an ultra vires gift or make a claim for repayment to the company. Similar

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claims are raised in relation to payments made to Bellwedge such as a claim to £86,868 in respect of the financial year ending 30 June 1984, being the excess over £45,000 described as the maximum total sum which Bellwedge was properly entitled to receive in respect of that year in respect of Mr. Korda's employment as a full-time executive of the company.

(3) The third category of claim is that based on infringements of section 42 of the Companies Act 1981, more especially in relation to Brindeel's purchase of 19,900 shares in the company.

(4) The fourth and last category of claim relates to expenses of the executive directors in respect of which it is alleged that the sums in question were not paid in respect of any expenses which the executive director concerned had ever incurred in rendering any services to the company. As regards those payments it is similarly alleged that they were in substance gifts, either to the executive director concerned or other persons, and therefore ultra vires the company and made by the executive directors concerned in fraudulent breach of fiduciary duties which constituted a fraud on the minority shareholders. Here again the issue is not whether the payment was made, for that is conceded, but whether it was a proper expense of the director concerned.

Finally as regards all the claims made the payments which it is sought to impeach were all made out of profits available for distribution. There is no question raised at any stage of an improper return of capital or potential fraud on creditors.

There have been earlier proceedings in this court in this action. Walton J. on 27 June 1986 discharged orders made the previous year by Master Chamberlain, notably an order made on 28 March 1985 on an ex parte application by the plaintiffs whereby he gave liberty to the plaintiffs to continue the action until the conclusion of discovery and inspection of documents, on terms that the company should pay the plaintiffs' costs on a common fund basis down to that stage of the action and indemnify the plaintiffs against any liability for costs down to that stage. The decision of Walton J. is reported as *Smith v. Croft* [1986] 1 W.L.R. 580. It is primarily concerned with the costs aspects of the matter with which I am not concerned but Walton J. observed of the application before him, at p. 591:

> "This is, of course, not an application to strike out the action on the grounds that it cannot be justified as a minority shareholders' action, but quite clearly the same kind of considerations apply."

Similarly it is my view that there is a very large degree of overlap in the material to be evaluated in the two applications.

Both parties agreed in submitting to me that I was not in any way bound by Walton J.'s findings or his view of the matter in that decision, but not surprisingly the plaintiffs submitted that Walton J.'s approach was wrong and not one which I should follow, whereas the fourth and ninth defendants invited me to reach similar conclusions to those which he reached and for the same reasons. The situation is not simplified for me by the facts that Walton J. refused leave to appeal, and May L.J. subsequently gave leave to appeal on 3 July 1986, directing that the

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appeal be not heard until the application to strike out, that is the application before me, was dealt with. It would be wrong for me to liken the Court of Appeal to the deep blue sea and even more wrong for me to liken Walton J. to the devil, but there is very clearly rather more scope than usual for any view I express to be in conflict with more authoritative ones. However, I have come to the conclusion that I should express my own views.

I adopt the same four-fold classification as that which I have used above in setting out the nature of the claims made by the plaintiffs in the statement of claim. I emphasise that, in assessing whether or not the plaintiffs have established a prima facie case that the company is entitled to the relief claimed, I am not deciding anything conclusively. In these circumstances it is undesirable for me to say more than is strictly necessary to give my reasons for the view I have formed. In particular I propose to deal differently with the questions of law which are involved in the determination of the first question which I have to answer, namely whether the plaintiffs have established a prima facie case that the company is entitled to the relief claimed, from those which are involved in the determination of the second question which I have to answer, namely whether the plaintiffs have established a prima facie case that the action falls within the proper boundaries of the exceptions to the rule in *Foss v. Harbottle*, 2 Hare 461. The former are bound to arise in the action if it proceeds and are in some cases dependent on findings of fact to be made in the action. The latter are unlikely to arise in the action, and in so far as questions of fact arise they are collateral to the issues in the action. I therefore propose only to give my prima facie view with regard to the former, but to decide the latter, more especially as they were very fully argued by counsel on both sides.

I return to the four categories of claim.

(1) *Payments made to an executive director purportedly by way of remuneration*

No arguable ultra vires claim arises here in my view. I take as the fundamental rule in considering the scope of what is properly called ultra vires, by which I mean beyond the capacity of the company as opposed to that of its officers, the following passage in the judgment of Slade L.J. in *Rolled Steel Products (Holdings) Ltd. v. British Steel Corporation* [1986] Ch. 246, 295:

> "if a particular act . . . is of a category which, on the true construction of the company's memorandum, is *capable* of being performed as reasonably incidental to the attainment or pursuit of its objects, it will not be rendered ultra vires the company merely because in a particular instance its directors, in performing the act in its name, are in truth doing so for purposes other than those set out in its memorandum. Subject to any express restrictions on the relevant power which may be contained in the memorandum, the state of mind or knowledge of the persons managing the company's affairs or of the persons dealing with it is irrelevant in considering questions of corporate capacity."

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On that basis, whereas the excessive remuneration of a director may well be an abuse of power where, as here, the power to decide on remuneration is vested in the board, it cannot be ultra vires the company. *In re George Newman & Co.* [1895] 1 Ch. 674 in my judgment supports that view.

Secondly, my impression on the evidence as to quantum is that the plaintiffs are more likely to fail than to succeed. In common with Walton J. I find the uncontradicted evidence of the very special field in which the company operates and the very high level of remuneration which obtains in that field very much more impressive than the statistics about general levels of professional remuneration which the plaintiffs adduced. I therefore do not find a prima facie case that the company is entitled to the relief claimed in this category of claim.

(2) *Payments to associated companies or to Billson*

The question whether these transactions can properly be claimed to be ultra vires is less clear cut than in relation to payments made to an executive director purportedly by way of remuneration. But my prima facie view is that the question should be answered similarly, that is to say that this is not an ultra vires claim at all.

On this aspect, the defendants' case was primarily based on the necessity for a proper characterisation of the payments made to the associated company or Billson. The evidence of invoices having been rendered by the company or firm for "services rendered," coupled with the absence of proper board resolutions of the company authorising such payments, and the absence of any evidence of a contractual link between the company and the relevant associated company or Billson, showed, it was argued, that there was no legal obligation whatever upon which the impeached payments could be based. In addition they were not shown in the company's accounts as directors' remuneration. Therefore they did not pass the characterisation test and qualify as remuneration, so as to be intra vires the company, whether or not proper as to quantum. Mr. Potts relied on *In re Halt Garage (1964) Ltd.* [1982] 3 All E.R. 1016. That was a case where a liquidator of a company compulsorily wound up challenged the validity of payments purportedly by way of remuneration both to a husband and a wife, a Mr. and Mrs. Charlesworth. The two of them were at all material times the only shareholders and directors. The impeached drawings were mainly made out of capital as opposed to profits and those in favour of the wife were made when, because of illness, she took no active part at all in the business. Oliver J. said in relation to the payments made to the husband, at pp. 1038, 1039:

> "I accept entirely the submissions of counsel for the liquidator that a gratuitous payment out of the company's capital to a member, qua member, is unlawful and cannot stand, even if authorised by all the shareholders. What I find difficulty in accepting is that, assuming a sum to be genuinely paid to a director-shareholder as remuneration under an express power, it becomes an illegal return of capital to him, qua member, if it does not satisfy some further test of being paid for the benefit of the company as a corporate entity. If he

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A genuinely receives the money as a reward for his directorship, the question whether the payment is beneficial to the company or not cannot, as I see it, alter the capacity in which he receives it: see, for instance, *Cyclists' Touring Club v. Hopkinson* [1910] 1 Ch. 179, 188. . . . What I think counsel's submission comes to is this, that while the company has divisible profits remuneration may be paid on any scale which the shareholders are prepared to sanction within B the limits of available profits, but that, as soon as there cease to be divisible profits, it can only lawfully be paid on a scale which the court, applying some objective standard of benefit to the company, considers to be reasonable. But assuming that the sum is bona fide voted to be paid as remuneration, it seems to me that the amount, whether it be mean or generous, must be a matter of management C for the company to determine in accordance with its constitution which expressly authorises payment for directors' services. Shareholders are required to be honest but, as counsel for the respondents suggests, there is no requirement that they must be wise and it is not for the court to manage the company.

"Counsel for the liquidator submits, however, that if this is right it leads to the bizarre result that a meeting of stupid or deranged D but perfectly honest shareholders can, like Bowen L.J.'s lunatic director, vote to themselves, qua directors, some perfectly outlandish sum by way of remuneration and that in a subsequent winding up the liquidator can do nothing to recover it. It seems to me that the answer to this lies in the objective test which the court necessarily applies. It assumes human beings to be rational and to apply E ordinary standards. In the postulated circumstances of a wholly unreasonable payment, that might, no doubt, be prima facie evidence of fraud, but it might also be evidence that what purported to be remuneration was not remuneration at all but a dressed-up gift to a shareholder out of capital, like the 'interest' payment in [*Ridge Securities Ltd. v. Inland Revenue Commissioners* [1964] 1 W.L.R. 479] which bore no relation to the principal sums advanced.

F "This, as it seems to me, is the real question in a case such as the present. I do not think that in circumstances such as those in the instant case the authorities compel the application to the express power of a test of benefit to the company which, certainly construed as Plowman J. held that it should be construed, would be largely meaningless. The real test must, I think, be whether the transaction G in question was a genuine exercise of the power. The motive is more important than the label. Those who deal with a limited company do so on the basis that its affairs will be conducted in accordance with its constitution, one of the express incidents of which is that the directors may be paid remuneration. Subject to that, they are entitled to have the capital kept intact. They have to accept the shareholders' assessment of the scale of that remuneration, H but they are entitled to assume that, whether liberal or illiberal, what is paid is genuinely remuneration and that the power is not used as a cloak for making payments out of capital to the shareholders as such."

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His conclusion on the facts as regards Mr. Charlesworth was as follows, at p. 1040: A

"Turning now to the facts of the instant case, it seems to me that the question which I have to determine is whether, on the evidence before me, I can say that the payments made to Mr. Charlesworth and to Mrs. Charlesworth were genuinely exercises of the company's power to pay remuneration . . ." B

and he concluded that it was, and he said, at p. 1041:

"But I do not think that, in the absence of evidence that the payments made were patently excessive or unreasonable, the court can or should engage on a minute examination of whether it would have been more appropriate or beneficial to the company to fix the remuneration at £*X* rather than £*Y*, so long as it is satisfied that it C was indeed drawn as remuneration. That is a matter left by the company's constitution to its members. In my judgment, a general meeting was competent to sanction the payments which he"—that is Mr. Charlesworth—"in fact drew and the claim in misfeasance against Mr. Charlesworth under this head must fail."

And he said, in connection with Mrs. Charlesworth, the wife, at p. 1042: D

"But of course what the company's articles authorise is the fixing of 'remuneration,' which I take to mean a reward for services rendered or to be rendered; and, whatever the terms of the resolutions passed and however described in the accounts or the company's books, the real question seems to me to be whether the payments really were 'directors' remuneration' or whether they were gratuitous E distributions to a shareholder out of capital, dressed up as remuneration.

"I do not think that it can be said that a director of a company cannot be rewarded as such merely because he is not active in the company's business."

and the rest of that paragraph was concerned with refuting that F proposition. Going on at the foot of the page, he said, at pp. 1042–1043:

"The difficulty that I felt about this at first was that there is, in relation to the misfeasance claim, which is the only claim with which I am concerned, no allegation of fraud or mala fides in relation to these payments. The liquidator's case has been argued throughout on the footing that they were payments of remuneration G but were also payments which could not be sanctioned by a general meeting because it was not for the benefit of the company to resolve on payments on this scale. For the reasons which I have endeavoured to state, I think that in circumstances such as exist in this case, where payments are made under the authority of a general meeting acting pursuant to an express power, the matter H falls to be tested by reference to the genuineness and honesty of the transaction rather than by reference to some abstract standard of benefit. I do not, however, think that bona fides (in the sense of absence of fraudulent intention) and genuineness are necessarily the

A same thing. It is not suggested here that there was any intent to defraud, but that cannot be conclusive. As Jessel M.R. remarked in *In re National Funds Assurance Co.* (1878) 10 Ch.D. 118, 128, to say that something is done bona fide is not the same thing as merely to say that the actor had no intention to commit a fraud. The real question is, were these payments genuinely director's remuneration? If your intention is to make a gift out of the capital of the company,
B you do not alter the nature of that by giving it another label and calling it 'remuneration'."

As a matter of fact he concluded that the payments to Mrs. Charlesworth were not genuine exercises of the power to remunerate at all. He said, at p. 1043:

C "I find it really impossible on the facts to hold that the whole of these sums, amounting to £1,500 per annum, drawn during the years 1968–69 and 1969–70, can be treated as genuine director's remuneration in any real sense of the term."

On the question whether the plaintiffs establish a prima facie case that these payments are ultra vires the company my finding is that they do
D not. For the reasons already given I state my reasons shortly. First, I am far from convinced that payments at the request of an executive director to an outside entity such as one of the associated companies or Billson is not capable of being a payment in respect of services physically rendered by the executive director concerned within the meaning of the test quoted above from the judgment of Slade L.J. in *Rolled Steel Products (Holdings) Ltd. v. British Steel Corporation* [1986] Ch. 246. Secondly,
E the fact that in some instances part only of a series of payments is attacked as ultra vires by the plaintiffs seems to me to lend strong support to this view. There are formidable difficulties in classifying any transaction as partly ultra vires. The analogy with the curate's egg seems to me compelling.

Thirdly, *In re Halt Garage (1964) Ltd.* [1982] 3 All E.R. 1016, was
F concerned with remuneration out of capital and not with the principle to be found in *In re George Newman & Co.* [1895] 1 Ch. 674, but in any event it is to be noted that the payments which were found to be ultra vires, those to Mrs. Charlesworth, were all ultra vires, and there could scarcely have been, on Oliver J.'s reasoning, a finding that payments to Mr. Charlesworth were partly ultra vires. Finally, if the payments to the associated companies are found to be shams, as Mr. Potts contends, the
G reality thus discovered is one of the executive directors drawing remuneration for themselves or at their direction, and although that is perfectly capable of being excessive and improper it is not in itself ultra vires. In short Mr. Potts' argument in my judgment places far too much weight on the label attached to the transaction for characterisation purposes.

H As to quantum the same considerations apply as to the claims about direct remuneration, which I dealt with earlier, but there is no doubt but that the plaintiffs are on stronger ground in criticising the mechanics of what was done. In particular, as regards the payments to Cushingham in the years ending 30 June 1981 and 1982, I find there was a prima facie

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case shown of irregularity not fully cured by the subsequent adoption of the accounts by the annual general meeting, at which the accounts, which should have disclosed those payments, were adopted.

(3) *Claims under section 42 of the Companies Act 1981*

Section 42 provides:

> "(1) Subject to the following provisions of this section and sections 43 and 44 of this Act, where a person is acquiring or is proposing to acquire any shares in a company it shall not be lawful for the company or any of its subsidiaries to give financial assistance directly or indirectly for the purpose of that acquisition before or at the same time as the acquisition takes place. (2) Subject to the following provisions of this section and sections 43 and 44 of this Act, where a person has acquired any shares in a company and any liability has been incurred (by that or any other person) for the purpose of that acquisition it shall not be lawful for the company or any of its subsidiaries to give any financial assistance directly or indirectly for the purpose of reducing or discharging the liability so incurred."

It is in relation to the latter subsection that it is claimed that financial assistance was given to Brindeel to the extent of the £28,000 loans made by associated companies to it. Financial assistance is defined by subsection (8):

> "In this section 'financial assistance' means—(*a*) financial assistance given by way of gift; . . . (*d*) any other financial assistance given by a company the net assets of which are thereby reduced to a material extent or which has no net assets. In this subsection 'net assets' has the same meaning as it has for the purposes of the 1980 Act."

The references to the purposes of the Companies Act 1980 is something of a trap for the unwary because it is a reference to the purposes of the Act of 1980 as amended by the Act of 1981. Section 87(4) of the Act of 1980 as originally enacted and so far as relevant read:

> "For the purposes of this Act—. . . (*c*) the net assets of a company are the aggregate of its assets less the aggregate of its liabilities; and in paragraph (*c*) above 'liabilities' includes any provision (within the meaning of Schedule 8 to the 1948 Act) except to the extent that that provision is taken into account in calculating the value of any asset of the company."

But paragraph 62(*b*) of Schedule 3 to the Companies Act 1981 provided for the substitution for the words from "(within the meaning of" to the end of section 87(4) the words "for liabilities or charges (within the meaning of paragraph 88 of Schedule 8 to the 1948 Act)." It will come as no surprise that Schedule 8 to the Act of 1948 only acquired a paragraph 88 at all by the operation of the Companies Act 1981, itself (see section 1(2) and Schedule 1), but if one assembles all the pieces of the jigsaw the result is I think as follows:

> "For the purposes of this Act (*c*) the net assets of a company are the aggregate of its assets less the aggregate of its liabilities and in

A paragraph (*c*) above liabilities includes any amount retained as reasonably necessary for the purpose of providing for any liability or loss which is either likely to be incurred or certain to be incurred but uncertain as to amount or as to the date on which it will arise."

There was some discussion in argument why this circuitous definition of "liabilities" was adopted in preference to the apparently identical B definition of "liabilities" in section 42(11) which only applies for the limited purposes of section 42(7). It appears that the difference between the two subsections (8) and (11) in relation to net assets resides in the different definitions to which they lead as regards "net assets" rather than "liabilities," but I am not directly concerned with that, there being no doubt but that section 42(7), which only applies to public companies, is irrelevant to the company here.

C The question which therefore emerges is whether the admitted payments to the associated companies of £33,000 plus V.A.T. thereon were payments of amounts retained as reasonably necessary for the purpose of providing for a liability likely to be incurred, that is to say the remuneration of the relevant executive director. The time at which this has to be assessed is early August. That was after the end of the D financial year in relation to which it is claimed that the remuneration was paid (viz. that ending 30 June 1982) so that the general financial picture of the result of the previous year's activities would be available but well before the accounts for that year were drawn up, let alone approved by the directors, an event which in relation to the first edition of these accounts did not occur until November 1982. I find that a prima facie case of infringement of section 42 of the Companies Act 1981 is E established primarily because it does not seem to me to be shown that these were amounts retained as reasonably necessary for the purpose of providing for the liability likely to be incurred of paying directors' remuneration. I say no more than that because I am not deciding the point.

On that footing there is no doubt that the claim is one in respect of F an ultra vires transaction, for it is conceded that a transaction in breach of section 42 of the Companies Act 1981 is ultra vires as well as illegal and not capable of ratification.

(4) *Claims in relation to directors' expenses*

I do not consider that there is an ultra vires claim established prima facie here. My reasons are similar to those in relation to direct G remuneration, the first category, and as to quantum I regard the report as rebutting a prima facie case in relation to matters arising before the date of the report, for in this instance, unlike the claims under section 42 of the Companies Act 1981, the report does seem to me to state a definite opinion which is based on wide experience and which I am content to adopt for the purposes of a prima facie view. For that limited H purpose I would also be prepared to regard the report as a general guide, even as regards expenses incurred after the time covered by the report itself.

The question now arises, more especially in relation to claims under section 42 of the Companies Act 1981 whether the plaintiffs have

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established a prima facie case that the action falls within the proper boundaries of the exceptions to the rule in *Foss v. Harbottle*, 2 Hare 461. The same question would arise if the view I have expressed regarding the other three categories of claim is wrong. A

In my judgment the arguments addressed to me on this aspect of the case raise two questions of law and one of mixed law and fact before an answer that the action does not fall within the proper boundaries of the exception to the rule in *Foss v. Harbottle* could be given. The questions of law can be formulated as follows. B

(1) Is a minority shareholder always entitled as of right to bring and prosecute an action for the company to recover money paid away in the course of a transaction which was ultra vires the company or is the prosecution of such an action susceptible of coming within the rule in *Foss v. Harbottle* so that there can be circumstances in which the court will not allow it to continue. C

(2) If the latter view is the correct one in relation to those categories of claims based on ultra vires transactions, and also in all cases of minority shareholders' actions to recover money for the company in respect of acts which constitute a fraud on the minority, will the court pay regard to the views of the majority of shareholders who are independent of the defendants to the action on the question whether the action should proceed? D

This process of ascertaining the views of the shareholders who are independent of the defendants to the action was described by Mr. Potts as a secondary counting of heads, an expression which did not much commend itself to Mr. Aldous but goes some way towards explaining what is involved. In terms of the present case the question is whether the court should have regard to the views of Wren Trust, Georgian Investments and Sir Reginald Sheffield, who do not want the action to continue, or is it conclusive that the defendants have voting control so that if the plaintiffs show a prima facie case of fraud on the minority they have a right to prosecute to the end an action for the company to recover in respect of the loss it has suffered, regardless of the views of the rest of the minority. Another way of putting the question is to ask whether if a minority has been the victim of a fraud entitling the company in which they are shareholders to financial redress, the majority within that minority can prevent the minority within that minority from prosecuting the action for redress. The usual reason in practice for wanting to abandon such an action is that there is far more to lose financially by prosecuting the right to redress than by abandoning or not pursuing it, and that view will be reinforced in the minds of those who wish to abandon the claim if their opinion is that it is a bad claim anyway. E F G

The third question which arises is whether in this case Wren Trust should be treated as independent, if the views of an independent majority are relevant? That is a question of fact. But it involves a question of law, namely what constitutes independence for this purpose? H

Upon the first question of law which arises, in my judgment the solution is to be found by a correct analysis of the rights which the minority shareholder is seeking to exercise or enforce in relation to

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A the result of an ultra vires transaction. There was no dispute before me but that any individual shareholder, be he in a minority or not, has a personal right to apply to the court to restrain a threatened action which if carried out would be ultra vires. Neither the right to object to such an action nor the shareholder's locus standi to bring proceedings admits of any doubt. The rule in *Foss v. Harbottle* poses no obstacle, because neither of the two bases for the rule is applicable, that is to say the B matter is not, by definition, a mere question of internal management nor is the transaction capable of ratification by or on behalf of the company. I was referred to two general statements of the rule. The first is in *Burland v. Earle* [1902] A.C. 83, where Lord Davey said, at p. 93:

"It is an elementary principle of the law relating to joint stock companies that the court will not interfere with the internal C management of companies acting within their powers, and in fact has no jurisdiction to do so. Again, it is clear law that in order to redress a wrong done to the company or to recover moneys or damages alleged to be due to the company, the action should prima facie be brought by the company itself. These cardinal principles are laid down in the well known cases of *Foss v. Harbottle*, 2 Hare 461 D and *Mozley v. Alston* (1847) 1 Ph. 790, and in numerous later cases which it is unnecessary to cite. But an exception is made to the second rule, where the persons against whom the relief is sought themselves hold and control the majority of the shares in the company, and will not permit an action to be brought in the name of the company. In that case the courts allow the shareholders complaining to bring an action in their own names. This, however, E is mere matter of procedure in order to give a remedy for a wrong which would otherwise escape redress, and it is obvious that in such an action the plaintiffs cannot have a larger right to relief than the company itself would have if it were plaintiff, and cannot complain of acts which are valid if done with the approval of the majority of the shareholders, or are capable of being confirmed by the majority. F The cases in which the minority can maintain such an action are, therefore, confined to those in which the acts complained of are of a fraudulent character or beyond the powers of the company. A familiar example is where the majority are endeavouring directly or indirectly to appropriate to themselves money, property, or advantages which belong to the company, or in which the other shareholders are entitled to participate, as was alleged in the case of G *Menier v. Hooper's Telegraph Works* (1874) L.R. 9 Ch.App. 350. It should be added that no mere informality or irregularity which can be remedied by the majority will entitle the minority to sue, if the act when done regularly would be within the powers of the company and the intention of the majority of the shareholders is clear. This may be illustrated by the judgment of Mellish L.J. in *MacDougall v. Gardiner* (1875) 1 Ch.D. 13, 25.

H "There is yet a third principle which is important for the decision of this case. Unless otherwise provided by the regulations of the company, a shareholder is not debarred from voting or using his voting power to carry a resolution by the circumstance of his having

a particular interest in the subject matter of the vote. This is shown by the case before this board of the *North-West Transportation Co. Ltd. v. Beatty* (1887) 12 App.Cas. 589. In that case the resolution of a general meeting to purchase a vessel at the vendor's price was held to be valid, notwithstanding that the vendor himself held the majority of the shares in the company, and the resolution was carried by his votes against the minority who complained."

The other general statement is in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204, 210 where a slightly condensed version of a passage from Jenkins L.J.'s judgment in *Edwards v. Halliwell* [1950] 2 All E.R. 1064, 1066 reads:

"The classic definition of the rule in *Foss v. Harbottle* is stated in the judgment of Jenkins L.J. in *Edwards v. Halliwell* [1950] 2 All E.R. 1064 as follows. (1) The proper plaintiff in an action in respect of a wrong alleged to be done to a corporation is, prima facie, the corporation. (2) Where the alleged wrong is a transaction which might be made binding on the corporation and on all its members by a simple majority of the members, no individual member of the corporation is allowed to maintain an action in respect of that matter because, if the majority confirms the transaction, cadit quaestio; or, if the majority challenges the transaction, there is no valid reason why the company should not sue. (3) There is no room for the operation of the rule if the alleged wrong is ultra vires the corporation, because the majority of members cannot confirm the transaction. (4) There is also no room for the operation of the rule if the transaction complained of could be validly done or sanctioned only by a special resolution or the like, because a simple majority cannot confirm a transaction which requires the concurrence of a greater majority. (5) There is an exception to the rule where what has been done amounts to fraud and the wrongdoers are themselves in control of the company. In this case the rule is relaxed in favour of the aggrieved minority, who are allowed to bring a minority shareholders' action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue."

I was also referred by both sides to two articles by Mr. Wedderburn on "Shareholders' rights and the rule in *Foss v. Harbottle*" [1957] C.L.J. 194, and [1958] C.L.J. 93, to which I should like to acknowledge my indebtedness.

I should also say at this stage that I have not in this judgment used the expressions "derivative" or "corporate" actions, terms which are often used to describe certain categories of minority shareholders' actions. There seemed to me to be a risk of apparent prejudging of issues by the use of such terminology.

The difficulty arises in this case when one considers not the restraint of an illegal or ultra vires transaction but the recovery on behalf of the company of money or property which the company is entitled to claim as the result of the ultra vires transaction. The submissions made to me

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A were as follows: Mr. Aldous, with Mr. Oliver's support, drew a distinction on behalf of the fourth and ninth defendants between those cases, on the one hand, where individual shareholders, despite the rule in *Foss v. Harbottle*, can bring a personal or representative action to enforce contractual rights that the memorandum and articles be observed, such rights not being removable by simple majority votes, and, on the other hand, those cases where what is sought to be done is to bring an B action in respect of loss already sustained by a company where the right of action is vested in the company, and an individual shareholder has, it is submitted, no personal right of action at all but can start an action on behalf of the company if, but only if, he can bring himself within one or other of two well established exceptions to the rule in *Foss v. Harbottle.* These are (1) Where the loss is attributable to an illegal or ultra vires C act, and (2) Where the transaction complained of constitutes a fraud on the minority shareholders.

They further submitted that even where there is a right to start an action to enforce a right of the company because one or other of the exceptions to the rule in *Foss v. Harbottle* is applicable, a company acting either through an independent board of directors or pursuant to a resolution passed by a majority of independent shareholders can always D compromise or waive the cause of action vested in it so long as the decision in question to compromise or waive is taken by the persons concerned bona fide and for reasons genuinely believed to be in the best interests of the company. If such a decision is taken any action started on behalf of the company by a minority shareholder should not be allowed to proceed.

E Mr. Potts, on the other hand, drew a distinction between those cases where the minority shareholder on behalf of the company was seeking to rescind a transaction carried out ultra vires and those where, without seeking to rescind the ultra vires transaction, the minority shareholder was seeking to recover damages or other compensation on behalf of the company. In the former Mr. Potts submitted the minority shareholder was entirely outside the rule in *Foss v. Harbottle* and had an indefeasible F right to bring and prosecute the proceedings. There was, he submitted, no difference in principle between his right to bring such proceedings for recission and recoupment and his right to restrain a threatened ultra vires transaction: both were personal rights vested in the individual shareholder which it was entirely within his power to bring or not. He also added that in cases where the plaintiffs rely on ultra vires G transactions it is not necessary to prove that the defendants have control of the company.

This latter point I can dispose of at once by accepting it. By itself, it does not advance the matter much. Mr. Potts did not contend that it was never possible for a company validly to abandon, compromise or decide temporarily not to pursue a right of action for damages vested in it as a result of an ultra vires transaction effected on its behalf, but he H submitted that the arguments advanced by the defendants involved denying the ultra vires doctrine altogether and that exactly the same wrong was involved in relation to a past ultra vires transaction as in relation to a prospective one, so that if the defendants' arguments based

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on a company's ability to release its cause of action in respect of a past ultra vires transaction were well founded, the same arguments would apply to a prospective ultra vires transaction, where it is common ground the minority shareholder has a right of action which the company cannot control. A

Treating the matter as a question of principle for the moment, when a minority shareholder seeks to enforce a right of the company to claim compensation for a past ultra vires transaction there are two quite separate rights involved. First, there is the minority shareholder's right to bring proceedings at all and secondly, there is the right of recovery which belongs to the company but is permitted to be asserted on its behalf by the minority shareholder. The passage I have quoted from Lord Davey's speech in *Burland v. Earle* [1902] A.C. 83, 93 makes it clear that the bringing of an action in the name of the company is mere matter of procedure in order to give a remedy for a wrong which would otherwise escape redress. That is an echo of what was said in one of the two cases often cited as the foundation for these doctrines, namely *Mozley v. Alston* (1847) 1 Ph. 790, 801, where Lord Cottenham L.C. said of a bill alleging that a large majority of the shareholders were of the same opinion as the plaintiffs: B C D

> "to allow, under such circumstances, a bill to be filed by some shareholders on behalf of themselves and others, would be to admit a form of pleading which was originally introduced on the ground of necessity alone, to a case in which no such necessity exists."

True it is the Court of Appeal in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204, 221 said that they were not convinced that it was a practical test to adopt to hold, as Vinelott J. had done at first instance, that there was an exception to the rule in *Foss v. Harbottle* wherever the justice of the case so requires. But the fact that such a yardstick would or might be unsatisfactory because it does not give a practical guide to the limits of the rule and its exceptions does not detract from the fact that the whole doctrine whereby a minority shareholder is permitted to assert claims on behalf of the company is rooted in a procedural expedient and adopted to prevent a wrong going without redress. Where what is sought is compensation for the company for loss caused by ultra vires transactions the wrong, in my judgment, is a wrong to the company, which has the substantive right to redress. Where the minority shareholder is seeking to prevent an ultra vires transaction or otherwise seeking to enforce his personal substantive rights, the wrong which needs redress is the minority shareholder's wrong. E F G

The peculiar status of the minority shareholder in such actions is also illustrated by the judgments in the Court of Appeal in *Towers v. African Tug Co.* [1904] 1 Ch. 558, where a company had declared and paid illegally a dividend out of capital and two shareholders who had themselves received their portion of the illegal dividend were held to be disentitled to bring an action on behalf of the company for repayment by the directors. Vaughan Williams L.J. said, at p. 566: H

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A "In that state of things, what ought to be done with this action? There is no doubt that the payment of this interim dividend was an ultra vires payment. I start with the assumption one is bound to make, that if an act is done by a company which is ultra vires, no confirmation by shareholders—not even by every member of the company—can convert that which was ultra vires into something intra vires: it always must be ultra vires. As is pointed out in one or B two of the cases, the result of that is that if the company are plaintiffs, no amount of acquiescence or resolutions by the shareholders can form an answer to the action by the company for the reinstatement of things in the position in which they would have been but for the ultra vires act complained of. But, to my mind, it is a different thing where the action is brought by a shareholder on C behalf of himself and other shareholders. I am assuming this case to be one of those in which the facts have been such that an individual shareholder ought to be able to sue in a representative action for the purpose of preventing acts being done in reference to the company in which the shareholders are interested, and which might damnify the company by reason of those acts being ultra vires. I assume that an action not only to prevent ultra vires acts in the D future but also to remedy acts that have been done ultra vires is an action which can be brought in the form in which this action is brought. But although that is so, my own opinion is that this is a kind of action which has to be brought by a plaintiff personally. It is an action which he cannot bring unless he has an interest; it is an action which a stranger could not bring."

E Stirling L.J. said, at p. 569:

"It is proved beyond all contradiction by documents under the hand of Mr. Towers that he was perfectly well aware of the circumstances in which the dividend was paid. It is true that Mr. Wedlake was not in the same position as Mr. Towers; but I think, having regard to the admissions which he made by not denying the allegation in the F counterclaim—that he received his dividend 'with full notice of all the facts relating thereto'—and to the fact of his having submitted to judgment against himself on that footing, and also having regard to the high probabilities of the case, that, inasmuch as he did not choose to go into the box and deny it, we ought to assume that he, like his partner Mr. Towers, knew the circumstances in which the G dividend was declared.

"Now the action is one by the plaintiffs on behalf of themselves and all other shareholders against the company; originally all the shareholders were not made parties, but the other shareholders were afterwards, at their own request, made defendants, so that now we have here all the shareholders of the company. I think this is a form of action which in certain circumstances may be maintained. H That a shareholder who had received a dividend, without knowing anything of the illegality of it, might maintain such an action I do not doubt. Whether in some circumstances a shareholder so suing ought not to return what he had received in respect of dividend is

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another question. Why is it that this form of action is allowed? Prima facie the proper plaintiff, where it is sought to bring back the property of the company into its own coffers, is the company itself. But there are exceptions to that rule; and what is the reason of the exceptions? Sir George Jessel M.R. in the case which has been referred to of *Russell v. Wakefield Waterworks Co.* (1875) L.R. 20 Eq. 474, 480, says this: 'The exceptions turn very much on the necessity of the case; that is, the necessity for the court doing justice.' "

Cozens-Hardy L.J. said, at p. 571:

> "An action in respect of or arising out of an ultra vires transaction ought properly to be brought by the company; but it has long been well established that there are cases in which such an action may be maintained by a shareholder suing on behalf of himself and all other shareholders against the company as defendants. I will not pause to consider under what particular circumstances such an action may be maintained, but I assume that this is one of those cases in which such an action may be maintained—I mean in point of form. But I think it is equally clear that the action cannot be maintained by a common informer. A plaintiff in an action in this form must be a person who is really interested. When you get that fact clearly established it seems to me impossible to avoid taking the next step—that all personal objections against the individual plaintiff must be gone into and considered before relief can be granted."

That decision illustrates the dual nature of the rights involved. The minority shareholder's locus standi as someone with a real interest greater than that of a common informer is defeasible by showing a personal disability to sue such as was present in *Towers v. African Tug Co.* But as Lord Davey said in *Burland v. Earle* [1902] A.C. 83, 93 the plaintiffs cannot have a larger right to relief than the company itself would have if it were plaintiff. And from that it follows in my judgment that if there is a valid reason why the company should not sue it will equally prevent the minority shareholder from suing on its behalf. He is therefore liable to be defeated on two points, first by any ground preventing him from exercising his procedural remedy, and secondly by any ground preventing the company from exercising its substantive right. Conversely, however, he is able to assert a cause of action which arose before he became a shareholder because it is the company's and not his substantive right that is being enforced: *Seaton v. Grant* (1867) L.R. 2 Ch.App. 459.

Where ultra vires transactions are involved the number of grounds upon which the company can be debarred from suing is limited. In particular it was not argued that ratification of the ultra vires transaction, by however large a majority of shareholders, could prevent the company from suing. There is, however, a clear difference in principle between ratifying what has been invalidly done in the past and abandoning, compromising or not pursuing rights of action arising out of a past ultra vires transaction, and I see no reason in principle why in appropriate

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A circumstances the latter should not intervene to prevent the prosecution of a suit on behalf of the company in relation to such rights of action.

Conversely I am not persuaded of the validity of the criterion suggested by Mr. Potts for separating actions brought by minority shareholders to recover property for the company into those where it is sought to rescind the relevant ultra vires transaction or otherwise have it set aside, on the one hand, and those where that transaction is not B sought to be set aside but damages or other compensation is claimed, on the other hand. The former according to Mr. Potts' argument fall entirely outside the rule in *Foss v. Harbottle*, while the latter are, he accepts, within its potential ambit. This distinction in my judgment places too much emphasis on the nature of the remedy sought rather than the substantive right and the legal person in whom it is beneficially C vested.

So much for the principles which seem to me to apply to the first legal question which falls for determination. Is there any authority which precludes me from giving effect to the view which I have expressed? I was referred to a very large number of authorities and I see no useful purpose in going through them all. There are certain discernible categories.

D (1) One category is where articles of association require a particular type of majority such as a special resolution and it has been held that a simple majority incapable of constituting such a majority cannot achieve indirectly what it is forbidden to achieve directly. An example is *Baillie v. Oriental Telephone and Electric Co. Ltd.* [1915] 1 Ch. 503, 511 where in the course of argument in relation to a submission by counsel that "If E the majority wish an action to be brought and it is found that the special resolutions were improperly obtained, then they would be nullified," Swinfen Eady L.J. said: "It might be opposed by a bare majority, with the result that a bare majority might supersede the necessity for a special resolution."

In his judgment he said, at p. 518:

> F "It was then contended that the plaintiff is not entitled to sue. The plaintiff's counsel urged that if this as a special resolution was invalidly passed, how is it to be impeached if the plaintiff cannot sue; how can the question of illegality be raised? Suppose he called a meeting and the majority of the shareholders were to say 'We are content with the present position, and we will not raise any question,' can it be said that by a side wind, as it were, not being G able to pass a valid special resolution, they could pass an invalid one and then by a bare majority say we will not allow any proceedings to be taken? In my opinion they cannot do that."

That type of case is concerned with preventing the indirect achievement of an unlawful object which raises different considerations from the recovery of compensation for past illegalities.

H (2) Another category consists of cases on demurrer, mostly in the middle and last part of the 19th century but including *Birch v. Sullivan* [1957] 1 W.L.R. 1247, although that case was concerned with misfeasance rather than ultra vires. Cases on demurrer are necessarily concerned

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with the locus standi of the plaintiff to bring the proceedings in question rather than the question whether a properly constituted action should be allowed to proceed. The cases principally relied on by Mr. Potts in this category included *Foss v. Harbottle*, 2 Hare 461 itself, where there were in fact two complaints made by the plaintiffs, one based on improper intra vires acts and the other on ultra vires activities described by Wigram V.-C., at p. 493, as mortgaging in a manner not authorised by the powers of the Act, and of which he said,

> "This, being beyond the powers of the corporation, may admit of no confirmation whilst any one dissenting voice is raised against it."

The first complaint is the context for the very famous statement of basic principle which has given the name of the case to the rule which has been applied on innumerable subsequent occasions.

Mr. Potts relied on this decision as supporting his submission that where there is no claim for rescission of an ultra vires transaction a minority shareholder may be debarred from bringing an action on behalf of the company and that Wigram V.-C. did not deal with what his position would have been had such a claim been made. I accept that submission which seems to me substantiated by the passage, 2 Hare 461, 504, 505:

> "The case made with regard to these mortgages or incumbrances is, that they were executed in violation of the provisions of the Act. The mortgagees are not defendants to the bill, nor does the bill seek to avoid the security itself, if it could be avoided, on which I give no opinion. The bill prays inquiries with a view to proceedings being taken aliunde to set aside these transactions against the mortgagees. The object of this bill against the defendants is to make them individually and personally responsible to the extent of the injury alleged to have been received by the corporation, from the making of the mortgages. Whatever the case might be, if the object of the suit was to rescind these transactions, and the allegations in the bill showed that justice could not be done to the shareholders without allowing two to sue on behalf of themselves and others, very different considerations arise in a case like the present, in which the consequences only of the alleged illegal acts are sought to be visited personally upon the directors. The money forming the consideration for the mortgages was received, and was expended in, or partly in, the transactions which are the subject of the first ground of complaint. Upon this, one question appears to me to be, whether the company could confirm the former transactions, take the benefit of the money that has been raised, and yet, as against the directors personally, complain of the acts which they have done, by means whereof the company obtains that benefit which I suppose to have been admitted and adopted by such confirmation. I think it would not be open to the company to do this; and my opinion already expressed on the first point is, that the transactions which constitute the first ground of complaint may possibly be beneficial to the company, and may be so regarded by the proprietors, and admit of confirmation. I am of opinion that this question,—the question of

A confirmation or avoidance,—cannot properly be litigated upon this record, regard being had to the existing state and powers of the corporation, and that therefore that part of the bill which seeks to visit the directors personally with the consequences of the impeached mortgages and charges, the benefit of which the company enjoys, is in the same predicament as that which relates to the other subjects of complaint. Both questions stand on the same ground, and, for B the reasons which I stated in considering the former point, these demurrers must be allowed."

The decision shows quite clearly that similar considerations are capable of applying to an action based on an ultra vires transaction as to a claim based on breach of duty so that the rule in *Foss v. Harbottle* can apply C to the former. It is not in any way conclusive on the nature of the minority shareholder's right to bring proceedings in respect of compensation for an ultra vires transaction.

In *Salomons v. Laing* (1850) 12 Beav. 377 the side note reads:

"The directors of one incorporated railway company paid over its funds to another railway company, for purposes wholly unauthorised; and the latter received them with knowledge of the breach of trust. D *Held*, on demurrer, that the second company were properly made parties to a suit to bring back the fund; and, secondly, that, in such a case, an individual shareholder in the first company might sue the second company 'on behalf' etc., without alleging that the corporation of which he was a member had refused to sue."

E The plaintiff's right to sue the directors and the South Coast Co., the first company referred to, was conceded and the only matters on which issue was joined on demurrer was whether the Portsmouth company, the second company referred to, could properly be joined as defendant and whether the plaintiff could sue them direct without proving that he had previously attempted to get the concurrence of the South Coast company to sue, both of which were answered in the affirmative. At its highest F the case proves no more than that a minority shareholder has a locus standi to bring an action for recovery of property paid out of a company in an ultra vires transaction and is not obliged to prove that an unsuccessful attempt to get the company to sue has been made. Neither of these is disputed.

Bagshaw v. Eastern Union Railway Co. (1849) 7 Hare 114 was G another case on demurrer but, contrary to the side note, was concerned not only with a threatened ultra vires application of funds but also with a past misapplication. Here again though, in my judgment, all that was decided was the plaintiff's locus standi to sue in respect of both past and threatened ultra vires activities. Wigram V.-C. said, at p. 129:

"No majority of the shareholders, however large, could sanction the H misapplication of this portion of the capital. A single dissenting voice would frustrate the wishes of the majority. Indeed, in strictness, even unanimity would not make the act lawful. This appears to me to take it out of the case of *Foss v. Harbottle*, 2 Hare 461 to which I was referred. That case does not, I apprehend, upon

this point, go further than this: that if the act, though it be the act of the directors only, be one which a general meeting of the company could sanction, a bill by some of the shareholders, on behalf of themselves and others, to impeach that act, cannot be sustained, because a general meeting of the company might immediately confirm and give validity to the act of which the bill complains."

Mr. Potts submitted that the passage showed that the rule in *Foss v. Harbottle* was not concerned with ultra vires transactions. That, in my judgment, is far too wide a proposition. In *Foss v. Harbottle* itself, as Mr. Potts rightly pointed out, Wigram V.-C. himself dealt in the same way with claims based both on intra vires but improper transactions and on ultra vires transactions. Certainly *Bagshaw's* case, 7 Hare 114 is authority for the proposition that a minority shareholder can in appropriate circumstances have a sufficient interest to bring an action for relief with regard to past as well as future apprehended ultra vires transactions. The fact that both past and future acts were involved might well constitute appropriate circumstances.

Russell v. Wakefield Waterworks Co. (1875) L.R. 20 Eq. 474 was a decision of Sir George Jessel M.R. that was concerned with recovery of some £5,500 claimed by plaintiff minority shareholders to have been paid out ultra vires to the promoters of a competing undertaking to dissuade them from promoting a bill in Parliament in competition with the company's undertaking. In terms the decision allowed a demurrer on the grounds that ultra vires was inadequately pleaded and there was no sufficient allegation that there was a reason preventing the company itself from suing. Jessel M.R. also examined what he described as the exceptions to the rule laid down in *Foss v. Harbottle*, and said, at p. 480: "the exceptions depend very much on the necessity of the case, that is the necessity for the court doing justice."

He identified two such exceptions. One he described, at p. 481, as cases "in which an individual corporator sues the corporation to prevent the corporation either commencing or continuing the doing of something which is beyond the powers of the corporation." He went on to point out that this may involve the joinder of a non-corporator who is a party to the ultra vires transaction, and that in turn may lead to the action embracing the recovery from that third party of money paid under such an ultra vires agreement. He continued, at pp. 481–482:

"If the detainer or holder of the money or property, that is, the second corporation or other person, is already a party, and a necessary party, to the suit, it would be indeed a lame and halting conclusion if the court were to say it could [not] do justice in a suit so framed by ordering the money to be returned or the property restored."—It is perfectly clear that the word "not" has dropped out between "could" and "do." The judgment continues—"It is a necessary incident to the first part of the relief which can be obtained by individual corporators, and will do complete justice on each side, and that has always been the practice of the court. Therefore, in a case so framed there is no objection to a suit by an

A individual corporator to recover from another corporator, or from any other persons being strangers to this corporation, the money or property so improperly obtained. But that is not the only case. Any other case in which the claims of justice require it is within the exception."

If anything that decision seems to me to assist the defendants, because B in relation to the ultra vires aspect of the matter it emphasises the necessity of flexibility to attain justice rather than the imposition of hard and fast rules.

In my judgment the above cases on demurrer establish that a minority shareholder can, as Mr. Potts argued, have a locus standi to bring an action to recover on behalf of a company property or money C transferred or paid in an ultra vires transaction and that it is not a necessary averment that control is vested in individual defendants so as to prevent the company from bringing the proceedings. I am not persuaded that it follows from that that the minority shareholder necessarily has an individual and indefeasible right to prosecute that action on the company's behalf.

(3) A third category of case which I only mention to dispose of is D made up of matters which the court concludes are mere matters of internal management. *MacDougall v. Gardiner* (1875) 1 Ch.D. 13 is an example. They are of no assistance to the present problem.

(4) A further category are those cases where an individual member either of a company or a trade union has been held to be entitled to restrain illegal activity by the company or association to which he E belongs. That in itself is not a subject of dispute. *Simpson v. Westminster Palace Hotel Co.* (1860) 8 H.L.Cas. 712 is House of Lords authority if it be needed. Of more help, however, are some modern trade union cases. Thus in *Edwards v. Halliwell* [1950] 2 All E.R. 1064, from which I have already cited the general statement by Jenkins L.J. quoted by the Court of Appeal in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204 there is what seems to me a revealing contrast in F the treatment by Jenkins L.J., at p. 1067, on the one hand, of acts complained of which are wholly ultra vires the company and therefore incapable of confirmation by a majority so that they constitute exceptions to the general ambit of the rule in *Foss v. Harbottle*, 2 Hare 461 and, on the other hand, cases such as *Edwards v. Halliwell* [1950] 2 All E.R. 1064 itself as to which Jenkins L.J. said, at p. 1067:

G "In my judgment, this is a case of a kind which is not even within the general ambit of the rule. It is not a case where what is complained of is a wrong done to the union, a matter in respect of which the cause of action would primarily and properly belong to the union. It is a case in which certain members of a trade union complain that the union, acting through the delegate meeting and H the executive council in breach of the rules by which the union and every member of the union are bound, has invaded the individual rights of the complainant members, who are entitled to maintain themselves in full membership with all the rights and privileges appertaining to that status so long as they pay contributions in

accordance with the tables of contributions as they stood before the purported alterations of 1943, unless and until the scale of contributions is validly altered by the prescribed majority obtained on a ballot vote. Those rights, these members claim, have been invaded. The gist of the case is that the personal and individual rights of membership of each of them have been invaded by a purported, but invalid, alteration of the tables of contributions. In those circumstances, it seems to me the rule in *Foss v. Harbottle* has no application at all, for the individual members who are suing sue, not in the right of the union, but in their own right to protect from invasion their own individual rights as members."

The boundary there seems to me very clearly drawn between suits in the right of the union and suits to protect the individual rights of members. The former are capable of coming within the rule in *Foss v. Harbottle*; the latter are not.

(5) Another category is to be found where the constitution of a corporation has been sought to be varied in a manner which is ultra vires, e.g. by amalgamation. *Clinch v. Financial Corporation* (1868) L.R. 5 Eq. 450, affirmed by the Court of Appeal at L.R. 4 Ch.App. 117, is an example of such a case, but the shareholder's right in such a case was described by Lord Cairns L.C., at p. 122, as a right to bring a suit to arrest a contract on the ground that it was in the eye of the court beneficial to all the shareholders to do so. Similarly Wood V.-C., who heard the case at first instance as well as in the Court of Appeal, said that every shareholder is supposed to have a common interest with the plaintiff in varying any arrangement that may have been entered into ultra vires. The fact that even such ultra vires arrangements are capable of being within the ambit of the rule in *Foss v. Harbottle* is shown very clearly by *Gray v. Lewis* (1873) L.R. 8 Ch.App. 1035 chosen by the court in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204, 217–219, as a simple application of the first aspect of the rule in *Foss v. Harbottle*, viz. that a company is the proper plaintiff to sue for redress for moneys due to it.

I turn now to a modern case from which I have derived much assistance. This is *Taylor v. National Union of Mineworkers (Derbyshire Area)* [1985] B.C.L.C. 237. The headnote reads:

"In September 1984 the plaintiffs, who were members of the Derbyshire Area of the National Union of Mineworkers (the Derbyshire union), were successful in obtaining, inter alia, a declaration that a strike called by their union (the Derbyshire union) and the National Union of Mineworkers (N.U.M.) was unlawful. The plaintiffs sought in the present proceedings by way of summary judgment an order restraining the defendants, who were the Derbyshire union and some of its officers, from using the funds of the Derbyshire union for the purpose of a strike called by the N.U.M. and the Derbyshire union, and requiring those defendants who were officers of the Derbyshire union to restore to the union funds which had been used for this purpose.

A "*Held*—Injunction granted: summary judgment on the monetary claim refused. Where a member of a union commenced an action on behalf of the union, the union would be treated as being analogous to a company and the member's standing to bring the action would be determined on the same principles as those applicable to an action brought by a shareholder on behalf of a company. These principles did not prevent an individual member from maintaining an action on behalf of the union against its officers where it was clear that the officers had made an ultra vires application of the funds which could not be ratified by the members. In such an action by a member of the union against its officers for the ultra vires misapplication of the union's funds, the court could order the officers responsible to restore the funds as such misapplication would constitute a breach of fiduciary duty. On the facts, it was clear that the Derbyshire union's funds had been used to support the strike and there was no reasonably arguable case that this payment was authorised by the union's rules or could be ratified by the members of the union. Accordingly, as a matter of principle, the plaintiffs were entitled to the order which they sought. However, although the making of the payment could not be ratified by the members of the union, the members could resolve to take no action to remedy the wrong done to the union provided that such resolution was made in good faith and for the benefit of the union. As there was evidence to suggest that the members might so resolve, and as the circumstances in this case were otherwise exceptional, the court would not grant summary judgment on the monetary claims."

Then there is a statement that an injunction to prevent future misapplications was available to them. Vinelott J. said, at p. 241:

"The first question is whether the plaintiffs are in a position to maintain an action against the individual defendants in effect on behalf of the Derbyshire union whose members have not been consulted on the question whether proceedings should be brought against the individual defendants. A great wealth of authority has been cited on this issue. The position, in my view, is not open to serious doubt."

He then proceeded to review the authorities, and said, at p. 246:

"The principles which emerge are, I think, clear. *Foss v. Harbottle* applies to a union but does not bar the right of an individual to maintain an action joining the union and its officers as defendants and claiming that a particular application by the officers was ultra vires and an injunction to restrain further application of the funds of the union for the same purposes and requiring the officers to make good the loss to the union. Being ultra vires the misapplication cannot be ratified by any majority of the members.

"The central issue in this case is whether the payments, amounting to over £1·7 million, were misapplications of the funds of the union within the exception to the rule in *Foss v. Harbottle.*"

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He answered that question, after a review of the authorities and facts, at p. 254:

"If that is the right conclusion, then it seems to me that it must follow that any payment to a member on unofficial strike whether by way of weekly allowance or by way of intermittent payment or by meeting expenses directly or in any other way with a view to making good the wages lost by the member on unofficial strike must be equally impermissible. So also must payments to pickets be impermissible. . . . I find myself therefore driven to the conclusion, uncomfortable though it is, that once it is accepted that the payments in question were made, as they admittedly were made, to pickets and otherwise in furtherance of the strike or for the relief of miners on unofficial strike from hardship caused by the stoppage of work and wages, the conclusions that follow inevitably are first that the payments were beyond the powers of the union; second, that the two officers, the second and third defendants, who made or sanctioned the payments, are liable to reimburse the union; third, that the plaintiffs are entitled to maintain this action; and fourth, that the misapplication of the union's fund cannot now be ratified by any majority of the members, however large. Should I therefore, make the order which is sought?

"I have come to the conclusion that I should not. My reasons are shortly as follows. Although the misapplication of the funds of a corporate body (I include for this purpose funds belonging to a union) cannot be ratified by any majority of the members, however large, it is open to a majority of the members, if they think it is right in the interests of the corporate body to do so, to resolve that no action should be taken to remedy the wrong done to the corporate body and such a resolution, if made in good faith and in what they considered to be for the benefit of the corporate body, will bind the minority. The majority of the members of a trading company, for instance, might properly take the view that the publicity, costs, and the inevitable loss, let us say, of the services of a managing director, who would be the defendant, would outweigh the benefit to the company of successfully prosecuting an action and might properly decide not to pursue it; although, of course, a contractual release of the right of action, as compared with a decision simply not to institute proceedings, would require to be supported by some consideration.

"In the instant case there is an impressive body of evidence filed on behalf of the defendants which is designed to establish that the overwhelming majority of members approves the expenditure in question. It must, I think, follow that they would most probably oppose proceedings for the recovery of the moneys misapplied."

He then went on to deal with three particular reasons advanced by counsel for the plaintiffs against a refusal to give summary judgment. They are particular to the facts of that case and neither the reasons nor the basis for Vinelott J.'s rejection of them is directly material to this case. Vinelott J.'s conclusions were stated, at p. 256:

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A "In these circumstances I have come to the conclusion that the right course is not to make an order for summary judgment in the hope that the action will come on, if it does come on, after this dispute has been settled, and that the members will be able to work together in the future for their common benefit within the rules of the union. It will be said that this is a case where hard cases make bad law. My reply to that is that it sometimes happens that hard B cases make good law, because they compel a radical re-examination of principles which, rigidly applied, would lead to a result which would be felt widely to be unjust. In particular, the boundary between ratifying a misapplication of a union's funds and resolving to take no action to recover funds innocently misapplied may not be easy to draw in the case of a union and this aspect of the case may, C I think, merit further consideration when the union is properly represented."

That authority draws the distinction between impossibility of ratification and the possibility of not suing in respect of the consequences of ultra vires transactions very clearly and in my judgment lends strong support to the view in principle which I have expressed. Overall therefore, on D the authorities cited to me, I conclude that there is some support for and no absolute bar on that conclusion.

Another consideration which tends in the same direction is that the plaintiffs have applied for, and until Walton J. discharged the master's order obtained, the benefit of an indemnity as to costs in respect of the action. There was never any suggestion that the plaintiffs were enforcing E personal rights in respect of the claimed ultra vires transactions as opposed to the rights of the company. On the contrary, the whole basis of the decision on which reliance was placed—*Wallersteiner v. Moir (No. 2)* [1975] Q.B. 373—was that the minority shareholder was acting for the benefit of the company rather than asserting an individual right.

Reliance was also placed by Mr. Aldous on *Viscount of the Royal Courts of Jersey v. Shelton* [1986] 1 W.L.R. 985 as supporting the F distinction between the impossibility of ratifying an ultra vires transaction and the possibility of a compromise or release of a right of action in respect of such a transaction. I accept Mr. Potts' submission that this authority is concerned with the rather different point how far articles of association can, outside this jurisdiction, which has a statutory prohibition, now contained in section 310 of the Companies Act 1985, confer an G immunity from suit on directors who participate in breaches of their fiduciary duty. That is not to say that I regard the distinction drawn by Mr. Aldous as an invalid one.

Mr. Potts further submitted that there were three objections to any reliance on a release, or the equivalent of a release, of the claims against defendants in relation to ultra vires acts. The first was that the right in question was that of the minority shareholder and not of the H company, so that neither the board nor the shareholders in general meeting could release it. That I have already dealt with.

Secondly, assuming it to be legally possible, he submitted first that the board had no available power to do so, and that, in the circumstances

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of the present case, is not in dispute; and secondly, that the company in general meeting could only do so by special resolution. The reason for this was that by article 80 of Table A which applies to the company the management of the business of the company is given to the directors. It followed that the shareholders could only pass a valid resolution about the conduct of proceedings, which it is common ground is part of the business of the company, by a resolution capable of altering the articles, i.e. a special resolution. In support he cited the passage in *Buckley on the Companies Acts*, 14th ed. (1981), vol. 1, p. 989, under the heading "How far members may control directors:"

> "There is no provision in this Act corresponding with section 90 of the Companies Clauses Consolidation Act 1845, which provides that the exercise by the board of their powers shall be subject to the control of any general meeting specially convened for the purpose. And it appears now to be established that under an article in the present form, whatever effect is to be given to the words 'to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting', these words do not enable the shareholders, by resolution passed at a general meeting without altering the articles, to give directions to the directors as to how the company's affairs are to be managed, nor to overrule any decision come to by the directors in the conduct of its business, even as regards matters not expressly delegated to the directors by the articles."

Mr. Aldous countered this submission by drawing a distinction between shareholders in general meeting seeking to compel directors to do that which they declined to do and shareholders in general meeting authorising or ratifying a matter which the directors considered to need their authority or ratification. In the former case a special resolution is needed: in the latter an ordinary resolution will suffice. In my judgment that distinction is validly made and is supported by Buckley J.'s decision in *Hogg v. Cramphorn Ltd.* [1967] Ch. 254. Buckley J. said, at p. 269:

> "Mr. Instone says, no doubt rightly, that the company in general meeting could not by ordinary resolution control the directors in the exercise of the powers under article 10. He goes on to say, with less justification, that what they could not ordain a majority could not ratify. There is, however, a great difference between controlling the directors' exercise of a power vested in them and approving a proposed exercise by the directors of such a power, especially where the proposed exercise of the power is of a kind which might be assailed if it had not the manifest approval of the majority. Had the majority of the company in general meeting approved the issue of the 5,707 shares before it was made, even with the purported special voting rights attached (assuming that such rights could have been so attached conformably with the articles), I do not think that any member could have complained of the issue being made; for in these circumstances, the criticism that the directors were by the issue of the shares attempting to deprive the majority of their constitutional rights would have ceased to have any force. It follows

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> that a majority in a general meeting of the company at which no votes were cast in respect of the 5,707 shares could ratify the issue of those shares. Before setting the allotment and issue of the 5,707 shares aside, therefore, I propose to allow the company an opportunity to decide in general meeting whether it approves or disapproves of the issue of these shares to the trustees."

B That passage was cited with approval by Harman L.J. in *Bamford v. Bamford* [1970] Ch. 212, 240–241. In my judgment it would not be right in a case where the court declines to act on the views of the board as not sufficiently disinterested, to assume that the board was not merely disqualified but also opposed to a decision by the shareholders in general meeting. I see no difference in principle between directors referring a doubtful matter to shareholders in general meeting and the C court taking into account the views of shareholders in general meeting where the directors are effectively disqualified from speaking for the company. On this aspect of the matter I accept Mr. Potts' submission that the Court of Appeal in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204, did not deal at all with the question what sort of resolution would have been needed regarding the D non-prosecution of the action.

Mr. Potts' third point was that in any event Wren Trust's views should not be taken into account. I propose to deal with that later.

I turn now to the question whether it is right for the court to have regard to the views of the majority inside a minority which is, I assume for this purpose, in a position to bring an action to recover on behalf of the company in respect of breaches of duty by persons with overall E control.

The fourth and ninth defendants claim that it is, the plaintiffs claim that it is not. On their view of the matter all that the court is concerned with, in cases where the exception to the rule in *Foss v. Harbottle*, 2 Hare 461 based on frauds on the minority applies, is the single question whether the defendants have control. The issue is highlighted by the F conflicting interpretations placed by the parties on what the Court of Appeal said in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204. Immediately after the formulation, at pp. 221–222, of the two matters which in the Court of Appeal's view a plaintiff ought at least to be required to show before proceeding with a minority shareholder's action there comes the following sentence:

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> "On the latter issue it may well be right for the judge trying the preliminary issue 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."

Mr. Potts submitted that the purpose of that adjournment was to enable H the courts to discern whether the defendants had control. I reject that submission. In my judgment the concern of the Court of Appeal in making that statement was to secure for the benefit of a judge deciding whether to allow a minority shareholder's action on behalf of a company to go forward what was described, at p. 221, as the commercial

assessment whether the prosecution of the action was likely to do more harm than good or, as it was put originally by counsel for Newman Industries Ltd., kill the company by kindness. The whole tenor of the Court of Appeal's judgment was directed at securing that a realistic assessment of the practical desirability of the action going forward should be made and should be made by the organ that has the power and ability to take decisions on behalf of the company. Also the question of control pure and simple hardly admitted of any doubt in that particular case.

Mr. Potts submitted, in the alternative, that what the Court of Appeal said was obiter. This I accept, but it was clearly a carefully considered statement contrasting with the express acknowledgment that they had had little argument on the proper boundaries of the exception to the rule in *Foss v. Harbottle*, 2 Hare 461 and were therefore not making any definitive statement on that subject, and I propose to follow what I understand to be the true construction of this statement albeit obiter, unless there is other authority binding on me the other way.

As to that Mr. Potts submitted that no reported authority held that in a case falling within the fraud on a minority exception to the rule in *Foss v. Harbottle* the court should go beyond seeing whether the wrongdoers are in control and count heads to see what the other shareholders, i.e. those other than the plaintiffs and the wrongdoers, think should be done. I accept that in many reported cases the court has not gone on to the second stage. *Mason v. Harris* (1879) 11 Ch.D. 97 is one such case, and there are modern examples too, such as *Pavlides v. Jensen* [1956] Ch. 565 and *Daniels v. Daniels* [1978] Ch. 406. But the fact that such an investigation was not conducted is not conclusive that it could not be conducted, more especially in the absence of any argument on this precise point. An investigation for interlocutory purposes of the propriety of the exercise of voting power in connection with the proposed prosecution of a minority shareholder's action was conducted by Sir Robert Megarry V.-C. in *Estmanco (Kilner House) Ltd. v. Greater London Council* [1982] 1 W.L.R. 2. In that case he permitted the action to proceed, but Mr. Aldous submitted that the careful scrutiny to which the propriety of the shareholders' voting activities was subjected is of itself an indication of the significance that the court in a proper case will attach to it. This I accept.

Another indication in the same direction is Walton J.'s reaction in the earlier proceedings in *Smith v. Croft* [1986] 1 W.L.R. 580 already referred to. He said, at p. 591:

> "This is, of course, not an application to strike out the action on the grounds that it cannot be justified as a minority shareholders' action, but quite clearly the same kind of considerations apply. If the majority of the independent shareholders do not wish the action to be continued, clearly the court will not sanction its continuance and certainly not at the expense of the company."

I accept that this is only by way of obiter for that particular question was not argued at that stage or before Walton J. but it represents the reaction of a judge very experienced in this field. In my judgment the

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word "control" was deliberately placed in inverted commas by the Court of Appeal in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204, 219 because it was recognised that voting control by the defendants was not necessarily the sole subject of investigation. Ultimately the question which has to be answered in order to determine whether the rule in *Foss. v. Harbottle* applies to prevent a minority shareholder seeking relief as plaintiff for the benefit of the company is "Is the plaintiff being improperly prevented from bringing these proceedings on behalf of the company?" If it is an expression of the corporate will of the company by an appropriate independent organ that is preventing the plaintiff from prosecuting the action he is not improperly but properly prevented and so the answer to the question is "No." The appropriate independent organ will vary according to the constitution of the company concerned and the identity of the defendants who will in most cases be disqualified from participating by voting in expressing the corporate will.

Finally on this aspect of the matter I remain unconvinced that a just result is achieved by a single minority shareholder having the right to involve a company in an action for recovery of compensation for the company if all the other minority shareholders are for disinterested reasons satisfied that the proceedings will be productive of more harm than good. If Mr. Potts' argument is well founded once control by the defendants is established the views of the rest of the minority as to the advisability of the prosecution of the suit are necessarily irrelevant. I find that hard to square with the concept of a form of pleading originally introduced on the ground of necessity alone in order to prevent a wrong going without redress.

I therefore conclude that it is proper to have regard to the views of independent shareholders. In this case it is common ground that there would be no useful purpose served by adjourning to enable a general meeting to be called. For all practical purposes it is quite clear how the votes would be cast, and that I described at the outset of this judgment. The questions therefore remain "What is the test of independence" and "Does Wren Trust pass it?"

Upon the former Mr. Potts submitted I should apply the test formulated in *In re Hellenic & General Trust Ltd.* [1976] 1 W.L.R. 123 by analogy. That decision was concerned with a scheme of arrangement and was accepted by Mr. Potts not to be direct authority, but he suggested that the passage in the judgment of Templeman J., at p. 125, provides appropriate guidance. He said:

> "The question therefore is whether M.I.T. [Manchester Investment Trust Ltd.], a wholly owned subsidiary of Hambros, formed part of the same class as the other ordinary shareholders. What is an appropriate class must depend upon the circumstances but some general principles are to be found in the authorities. In *Sovereign Life Assurance Co. v. Dodd* [1892] 2 Q.B. 573, the Court of Appeal held that for the purposes of an arrangement affecting the policyholders of an assurance company the holders of policies which had matured were creditors and were a different class from policyholders whose policies had not matured. Lord Esher M.R.

said, at p. 580: 'they must be divided into different classes . . . because the creditors composing the different classes have different interests; and, therefore, if we find a different state of facts existing among different creditors which may differently affect their minds and their judgment, they must be divided into different classes.' Bowen L.J. said, at p. 583: 'It seems plain that we must give such a meaning to the term "class" as will prevent the section being so worked as to result in confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.' Vendors consulting together with a view to their common interest in an offer made by a purchaser would look askance at the presence among them of a wholly owned subsidiary of the purchaser."

Mr. Oliver, on the other hand, took me through a line of authority regarding the efficacy of resolutions passed by or with the help of votes whose validity was impugned. From *Allen v. Gold Reefs of West Africa Ltd.* [1900] 1 Ch. 656 onwards there has been applied a test whether the votes in question were exercised bona fide for the benefit of the company as a whole. The generality of the test has led to differences of judicial opinion on the result of applying it to a particular set of facts, notably in that particular case. That is further illustrated by the different results reached on not very dissimilar facts in *Brown v. British Abrasive Wheel Co. Ltd.* [1919] 1 Ch. 290 and *Sidebottom v. Kershaw, Leese & Co. Ltd.* [1920] 1 Ch. 154. In my judgment in this case votes should be disregarded if, but only if, the court is satisfied either that the vote or its equivalent is actually cast with a view to supporting the defendants rather than securing benefit to the company, or that the situation of the person whose vote is considered is such that there is a substantial risk of that happening. The court should not substitute its own opinion but can, and in my view should, assess whether the decision making process is vitiated by being or being likely to be directed to an improper purpose.

In general terms I would seek to apply the test applied by the Court of Appeal in *Allen v. Gold Reefs of West Africa Ltd.* [1900] 1 Ch. 656, but it seems to me possible to formulate a more particular one in the circumstances of this case. The analogy with schemes of arrangement and *In re Hellenic & General Trust Ltd.* [1976] 1 W.L.R. 123, is a good deal less compelling. Moreover the application of such a test as I have indicated should prevent any risk of the danger that Mr. Potts relied upon of the resolution which prevents proceedings being brought on behalf of the company being itself treated as a fraud on the minority.

The question thus arises whether Wren Trust's decision, which is the equivalent of a vote, passes the test or is vitiated by being directed to an improper purpose. The evidence filed by the defendants on this issue consist of two affidavits by Mr. Carr and two by Mr. Baldock, who is the managing director of Gresham Trust Plc. and a director of Wren Trust, its subsidiary. Mr. Baldock deposed in an affidavit sworn on 1 July 1985:

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"(4) As a director of Gresham Trust and Wren Trust I am involved in making a number of investments in unquoted companies. I can say that, without doubt, the investment in Film Finances has been, both in terms of capital appreciation and income, a very successful investment. For the reasons set out in Mr. Carr's affidavit I am of the opinion that the remuneration which has been paid to Messrs. Soames, Korda and Croft is in all the circumstances reasonable.

B

"(5) The present litigation is a source of some considerable concern to Gresham Trust and Wren Trust in that it jeopardises a valuable investment. My reasons for so stating are that, as a professional investor, I am of the view that Mr. Soames represents the principal asset of the company. The present proceedings, purportedly brought on behalf of the company, are thus a personal attack on the company's principal asset. Whilst Mr. Soames has a substantial equity stake in the company he is not bound to the company by a long term service contract. There is therefore no reason why if Mr. Soames became so disenchanted with the present litigation he could not either set up business on his account in this country or seek alternative employment in the same industry in the United States of America. I have no doubt that in view of the record of the company he would have little difficulty in either obtaining the necessary finance to commence business on his own account or to find alternative employment in the United States of America at the same or a higher salary.

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"(6) If Mr. Soames were to leave the company the effect upon the investment of all the minority shareholders in the company would in my opinion be catastrophic and, even if it were possible to replace Mr. Soames, then I verily believe that the remuneration which would have to be paid for an appropriate replacement would be at the same level or in excess of that which Mr. Soames is already receiving.

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"(7) The statement of claim in these proceedings alleges that the proceedings are brought for the benefit of all shareholders. Wren Trust as a minority shareholder holding some 19·66 per cent. of the issued share capital of the company is of the view: (i) that the remuneration which has been paid to the executive directors is in all the circumstances reasonable; (ii) that the present proceedings are not for the benefit of the minority shareholders; and (iii) that if the present proceedings continue they will put in jeopardy the value of the investment of all the minority shareholders."

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After the independence of Wren Trust had been challenged he swore a further affidavit on 18 March 1986 in which he said:

"(5) Wren Trust Ltd. is not a party to the present proceedings. However, it has been suggested that because the non-executive chairman of Film Finances Ltd., Mr. Carr, is a director of Wren Trust and Gresham Trust, Wren Trust cannot properly be said to be an independent shareholder. In this regard, the board of Gresham Trust and the board of Wren Trust have carefully considered the passage in the judgment of Walton J. . . .

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"(6) The directors of Gresham Trust and the directors of Wren Trust have been advised that this Honourable Court would be entitled to disregard the views of Gresham Trust and Wren Trust in assessing whether a majority of the independent shareholders considers that the proceedings are for the benefit of Film Finances Ltd., if they are allowed their consideration of the merits of the present proceedings to be influenced by the fact that Mr. Carr is a defendant in the proceedings.

"(7) The directors of Gresham Trust and the directors of Wren Trust (excluding in each case Mr. Carr) have carefully considered the issues in the present action, the affidavits sworn herein and the judgment of Walton J. For the reasons already set out in my first affidavit . . . and in the affidavit of Mr. Carr . . . they have concluded that the present proceedings are not only of no benefit to Film Finances Ltd. but they put at risk the investment of Gresham Trust and Wren Trust in Film Finances Ltd. Accordingly, the directors of Gresham Trust and the directors of Wren Trust (excluding in each case Mr. Carr) have resolved to support the application by Film Finances Ltd. to strike out the present proceedings, and any application which Mr. Carr may be advised to make to strike out the present proceedings, and I have been authorised to swear this affidavit in support of such applications."

Then he exhibits minutes of the relevant board meetings. That in relation to Wren Trust recorded that Mr. Scott, a solicitor, reported on the present state of the proceedings which had been commenced by three minority shareholders in Film Finances Ltd. where Wren Trust Ltd. is a substantial minority shareholder, and then he refers to the application before Walton J. and the possibility of an appeal. There being no questions of a factual nature Mr. Carr then left the meeting, and the minute then said:

"Mr. Scott explained to the meeting that in considering Film Finances' application to dismiss the proceedings the court would wish to have regard to the views of the independent shareholders. In considering the merits of the proceedings and whether the board considered that the prosecution of the proceedings was in the best interests of Film Finances Ltd. the board must disregard the fact that one of its number was the defendant in the proceedings. The directors should only have regard to the effect of the present proceedings upon its investment in Film Finances Ltd. If, for the reasons set out in the affidavits already sworn by Mr. Carr and Mr. Baldock, the board considered that there were good commercial reasons why the proceedings were not in the best interests of Film Finances Ltd., then it should resolve to support Film Finances' application to dismiss the proceedings, and on the basis of Walton J.'s judgment there was no reason why the court should not take note of Wren Trust's view as to the merit of the proceedings."

And then the resolution is recorded.

An attempt was made on behalf of the plaintiffs to adduce evidence to show that Mr. Baldock as well as Mr. Carr was personally interested

A but that attempt was not persisted in or relied upon at the hearing before me. I need not therefore take up time dealing with it. But the fact that it was made and that repeated offers to tender Mr. Baldock for cross-examination on this issue of the independence of Wren Trust were not taken up is, in my judgment, some indication of the weakness of the plaintiff's case on that issue.

B Mr. Potts relied on evidence that showed that Wren Trust has been described as an associate of the executive directors. I accept that there is evidence that Wren Trust sided with the executive directors in the board room tussle that resulted in Mr. Garrett's resignation as a director of the company and could properly be described as associates in that context, and that there is evidence that Gresham Trust itself was involved in the share transactions leading up to Mr. Garrett's resignation. I nevertheless C remain firmly of the view that there is no sufficient evidence that in relation to the present question whether these proceedings should continue Wren Trust has reached its conclusion on any grounds other than reasons genuinely thought to advance the company's interests. It is not for me to say whether the decision itself is right or wrong. It is for me to say whether the process by which it was reached can be impugned D and I hold that it cannot. Nor do I consider that in the circumstances there is shown to have been a substantial risk of Wren Trust's vote having been cast in order to support the defendants as opposed to securing the benefit of the company.

That conclusion means that I accede to the fourth and ninth defendants' motions and direct that the statement of claim be struck out. Before parting with the case I should like to say a further word about E the procedure.

Mr. Potts at the end of his long and helpful addresses described the procedure as a shambles. Without going to those lengths I do agree that it had unsatisfactory features not least the length of time taken. The order of speeches did not in the event match the onus of proof and although I doubt whether in the course of his marathon Mr. Potts left F any ground uncovered, nevertheless that was another unsatisfactory feature. It may very well be that the Court of Appeal will have an opportunity of elaborating what was said in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204.

For my part I would say three things. First, I consider there may well be a much stronger case for requiring a prospective plaintiff to have the G onus of establishing that his case falls within the exceptions to the rule in *Foss v. Harbottle*, 2 Hare 461 or outside it altogether than there is for putting the same onus upon him to show that the company would be likely to succeed if it brought the action. Upon the latter it might well be appropriate to apply the usual test under R.S.C., Ord. 18, r. 19 and the inherent jurisdiction which puts the onus on the defendants to show the case is effectively unarguable.

H Secondly, I consider it would be highly desirable for applications in respect of costs under *Wallersteiner v. Moir (No. 2)* [1975] Q.B. 373 procedure to be made at the same time as the plaintiff establishes whatever it is that he does have to establish. A great deal of expense

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has been caused in this case by the piecemeal way in which the matter has proceeded.

Thirdly I believe that it would be helpful for there to be specific procedure laid down, whether by way of rules of court or practice direction I know not, for the initiation and prosecution of actions by minority shareholders to recover on behalf of a company.

Statement of claim struck out as against fourth and ninth defendants with costs on standard basis.
Leave to appeal.

Solicitors: Gouldens; Herbert Smith & Co.; Harbottle & Lewis.

T. C. C. B.

[CHANCERY DIVISION]

RIGNALL DEVELOPMENTS LTD. v. HALIL

[1986 R. No. 3142]

1987 Feb. 19; March 10 — Millett J.

Vendor and Purchaser—Defective title—Completion notice—Adverse entry in local land charges register—Condition of sale that purchaser deemed to have searched local land charges register—Whether vendor relieved of duty to make full and frank disclosure—Whether purchaser deemed to have notice of entry in register—Law of Property Act 1925 (15 & 16 Geo. 5, c. 20), s. 198(1)[1]

The defendant was the freehold owner of a house let to a protected tenant and the defendant's predecessor in title had applied to the local authority for an improvement grant under the Housing Act 1974. The grant was approved and registered by the local authority in the register of local land charges and that encumbrance could be removed on payment pursuant to the provisions of the Act. At the time the defendant purchased the property, her solicitors knew that the charge had been registered. Subsequently the defendant decided to dispose of the property by sale at auction and it was a condition of the contract that the purchaser was deemed to have made local

[1] Law of Property Act 1925, s. 198(1): see post, p. 199F–G.

Neutral Citation Number: [2021] EWCA Civ 1176

Case No: A3/2020/1162

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
BUSINESS LIST (ChD)
Stephen Houseman QC (sitting as a Deputy Judge of the High Court
[2020] EWHC 1136 (Ch) and [2020] EWHC 1352 (Ch)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 28/07/2021

Before:

LORD JUSTICE HENDERSON
LORD JUSTICE WARBY
and
SIR DAVID RICHARDS

- -

Between:

(1) BOSTON TRUST COMPANY LIMITED (2) BOSTON FIDUCIARY MANAGEMENT LIMITED	**Claimants/ Respondent**
– and –	
GORDON VERHOEF	**Defendant/ Appellant**

- -
- -

Mark Tempest (instructed by **Woodroffes Solicitors**) for the **Appellant**
Anna Dilnot QC (instructed by **Osborne Clarke**) for the **Respondents**

Hearing dates: 28 April 2021

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Approved Judgment

Covid-19 Protocol: This judgment was handed down remotely by circulation to the parties' representatives by email and release to Bailii. The date for hand-down is deemed to be on 28 July 2021.

Sir David Richards:

Introduction

1. This is an appeal against an order giving conditional permission to continue a derivative action.

2. The claimants issued the proceedings, on the basis that they were registered shareholders of the fourth defendant Tellisford Limited (Tellisford). They seek relief on behalf of three subsidiaries of Tellisford. After a full hearing of the permission application, Mr Stephen Houseman QC, sitting as a Deputy Judge of the High Court, held that it was a suitable case in which to give permission, save that the claimants were not registered shareholders and did not otherwise have standing to pursue the derivative claims. The claimants had issued proceedings for rectification of the register of members of Tellisford to show them as shareholders and it appeared to the judge that they had at least a good arguable case for rectification. In those circumstances, by an order dated 28 May 2020, he granted permission to continue the action, on the condition that the claimants became registered as shareholders of Tellisford, whether pursuant to their rectification claim or otherwise.

3. The judge gave the defendants permission to appeal, limited to whether the court had jurisdiction to grant conditional permission and, if so, whether he had been right to exercise his discretion to grant it. He observed that there was no prior authority for the grant of conditional permission (and we have been shown none) and both sides agreed that it was a suitable case for permission to appeal. The defendants' application for permission to appeal on other grounds was refused both by the judge and by Lewison LJ. The present appeal is brought by the fifth defendant, Gordon Verhoef (the appellant).

4. The significance of these issues in these proceedings is now much reduced because, by an order of the High Court made on 23 July 2020 (the rectification order), it was ordered that the register of members of Tellisford be rectified so as to record the claimants as the joint holders of 95 A ordinary shares from 3 June 2016 and 5 B ordinary shares from 9 October 2018.

5. The effect of this order is that the claimants are deemed to have been members of Tellisford for all purposes from the dates specified in the order: see *Re Starlight Developers Ltd* [2007] EWHC 1660 (Ch), [2007] BCC 929 (*Re Starlight*) at [10], citing the decision of this court in *Re Sussex Brick Company* [1904] 1 Ch 598. It follows that, for all relevant legal purposes, the claimants are deemed to have been members of Tellisford, with standing to bring these proceedings, both when the present proceedings were issued in October 2019 and when the permission application was heard in April 2020.

6. Mr Tempest, appearing for Mr Verhoef, submitted that we should approach the appeal on the basis of the facts as they appeared at the date of the judge's order. In my judgment, this is not a legitimate approach for the court to adopt. In view of the legal effect of the rectification order, and the judge's conclusion that on all relevant grounds other than standing permission should be granted, it can now be seen that the proper order was the grant of unconditional permission.

7. The claimants submitted that the judge was right to make the conditional order and that it should remain in place. They fulfilled the condition imposed by the order by obtaining the rectification order, so since 23 July 2020 they have had unconditional permission. Mr Verhoef opposed this course.

8. We took the view at the hearing of the appeal that we should hear argument on the issues raised by the appeal, both because it raised an issue of principle with potential impacts beyond this case and because the judge's order for conditional permission should not remain in place if we were satisfied that it should not have been made.

Background

9. The first to third defendants (the operating companies) are trading subsidiaries of Tellisford, which is the holding company for a group carrying on a well-established stone restoration and repair business in the UK under the Szerelmey name. The ultimate controllers of the group are Mr Verhoef and Mr Earl Krause. They, together with Mr Verhoef's wife and Mr Krause's son, are the directors of Tellisford. The share capital of Tellisford comprises 190 A ordinary shares and 10 B ordinary shares. Family trusts established by Mr Verhoef and by Mr Krause each own 95 A ordinary shares. The B ordinary shares were owned by a Mr David Maughan but by a stock transfer form dated 9 October 2018 he transferred 5 shares to Mr Krause's trust.

10. Having worked closely together for some 60 years, the relationship between Mr Verhoef and Mr Krause broke down in late 2015/early 2016 and, as is common ground, Mr Verhoef excluded Mr Krause from participation in the business.

The proceedings

11. On 1 October 2019, the claimants in their capacities as trustees of Mr Krause's trust (the Erutuf trust) issued the present proceedings, claiming relief on behalf of the operating companies in respect of alleged misappropriations of assets of those companies. The claims are made against Mr Verhoef and five companies alleged to have assisted in the misappropriations or to have received the assets. It is unnecessary to go into the detail of the claims.

12. Prior to the issue of the proceedings, the claimants applied without notice for personal and proprietary freezing injunctions. They also applied at that stage, again without notice, for permission to continue the claim as a derivative claim. The injunctions were refused, but permission was granted pending a full hearing of the application.

Derivative claims

13. These are so-called double derivative claims or (where there are one or more intermediate holding companies, as is the case with one of the operating companies) multiple derivative claims, whereby members of a holding company bring proceedings to enforce claims, not on behalf of the company of which they are members, but on behalf of subsidiaries of that company.

14. They are not subject to the regime set out in Chapter 1 of Part 11 of the Companies Act 2006 (the statutory regime). This arises from the definition in section 260(1) of a "derivative claim" as proceedings "by a member of a company (a) in respect of a

cause of action vested in the company, and (b) seeking relief on behalf of the company". The definition of a "member" of a company is for these purposes extended from its general definition of a person who has agreed to become a member and whose name is entered in the company's register of members (section 112(2)) but only so as to include a person to whom shares have been transferred or transmitted by operation of law (section 260(5)(c)). The claim must therefore be made by a member of the company on whose behalf the claim is made, or by a person entitled to shares in that company by transfer or transmission.

15. The circumstances in which double and multiple derivative claims may be brought remain governed by the common law rules, known as the exceptions to the rule in *Foss v Harbottle* (1843) 2 Hare 461: *Universal Project Management Services Ltd v Fort Gilkicker Ltd* [2013] EWHC 348 (Ch), [2013] Ch 551 (*Fort Gilkicker*) and *Abouraya v Sigmund* [2014] EWHC 277 (Ch).

16. There was no requirement until relatively recently for a claimant to apply for permission to continue a derivative claim. The practice was for the defendants to apply to strike out a derivative claim if they considered that it did not fall within the exceptions to the rule in *Foss v Harbottle*. This ceased to be the practice when, with effect from 2 May 2000**,** CPR 19 was amended by the introduction of a new rule 19.9, which required the claimant in a derivative claim on behalf of a company, other incorporated body or trade union to apply to the court for permission to continue the claim after issue of the claim form.

17. CPR 19 was amended with effect from 1 October 2007, when the statutory regime came into force. CPR 19.9A and 19.9B deal with claims to which the statutory regime applies, while CPR 19.9 (re-drafted), 19.9C and 19.9D apply to other derivative claims.

18. It is common ground in the present case that the claimants were required to obtain permission to continue the proceedings after the issue of the claim form. I consider this to be correct but, unlike the judge, I do not think that this requirement arises, strictly speaking, under CPR 19.9.

19. CPR 19.9 applies to "a derivative claim" which is defined in 19.9(1)(a) as being brought "where a company, other body corporate or trade union is alleged to be entitled to claim a remedy, and a claim is made *by a member of it* for it to be given that remedy" (emphasis added). Just as those words in section 260 of the Companies Act 2006 have been construed as limiting the statutory regime to "single" derivative claims (see the authorities cited above) so, as it seems to me, the same result must follow in CPR 19.9. It was submitted to us that 19.9 extends to double and multiple derivative claims by virtue of the words "whether under Chapter 1 of Part 11 of the Companies Act 2006 *or otherwise*" in 19.9(1)(a). It seems clear to me that "or otherwise" encompasses claims on behalf of an "other body corporate or trade union" and does not qualify the requirement that the claim must be made by a member of the company, other body corporate or trade union alleged to be entitled to claim a remedy. Reference was also made to PD19C which uses the expression "derivative claim" but, in my view, this cannot be taken to have a wider meaning than in CPR 19. The purpose of PD19C is not to widen CPR 19 but, as it states, to supplement it. In this respect, I do not agree with the observation made by Briggs J in *Fort Gilkicker* at [53] on the basis, it appears, of common ground. It may be that the Rules Committee

would wish to look at whether the application of CPR 19.9 to double and multiple derivative claims should be clarified.

20. Nonetheless, it is the settled practice of the court to require permission to be obtained for double and multiple derivative claims. In my judgment, the court is entitled and right to impose this requirement, and to apply by analogy the practice in CPR 19.9. As the underlying claims are necessarily vested in the company, a member of its holding company has no right to bring a derivative claim, save as permitted by statute or the common law. In the latter case, just as the courts have laid down the circumstances in which derivative claims may be brought, so they may develop the procedure to which they are subject.

The claimants' standing

21. In preparation for a full hearing of the application for permission, substantial evidence was filed by the parties dealing with all the matters which the claimants needed to show in order to obtain permission. The first of these matters was their standing to bring the claims. The claimants asserted, as they believed to be the case, that they were members of Tellisford.

22. In evidence filed on behalf of the defendants in November 2019, the assertion was made that the claimants were not members and so did not have standing to bring the claims. As I describe below, that proved to be correct.

23. The facts relevant to the claimants' status were as follows.

24. The Erutuf Trust was established in 2000 with Isle of Man Financial Trust Limited (IoMFT) as its original trustee. Tellisford was incorporated on 8 December 2003, on which date a return of allotments showed that the A ordinary shares had been allotted to IoMFT. The annual returns for the years from 2004 to 2014 recorded that the A ordinary shares were held by IoMFT. Notwithstanding those documents, from 2004 the register of members of Tellisford showed 95 A ordinary shares as held by "Erutuf Trust IOM", not by IoMFT. Erutuf Trust IOM was not a legal person capable of being registered as the holder of shares.

25. In April 2013, IoMFT resigned as trustee of the Erutuf Trust and was replaced by Andrew Douglas Ash and Alexander Fleming McNee, who were directors or otherwise involved with IoMFT. They resigned in June 2016 and were replaced by the claimants.

26. Notwithstanding the changes in trustees, no steps were taken to transfer the A ordinary shares registered in the name of Erutuf Trust IOM to either Mr Ash and Mr McNee or to the claimants. In April and May 2020, the claimants sought the agreement of Tellisford and Mr Verhoef to correct the position but, even after the necessary share transfer forms had been executed, they refused to co-operate and the claimants were left to issue their application for rectification of the register on 16 April 2020, very shortly before the hearing of the permission application. It was only after the rectification order was made on 23 July 2020 that they were registered as members of Tellisford.

The first judgment

27. The claimants' application for permission was heard by the judge on 22 and 23 April 2020 and he gave his first judgment on 7 May 2020. He carefully and fully considered all the issues relevant to the grant of permission, including an assessment of the merits of the claims. He was aware of, and referred to, the claimants' rectification application, and that it was opposed by Mr Verhoef. He recorded that he had been told that it would be determined within a few months.

28. The judge identified the question of the claimants' standing as the first of twelve issues arising on the application. He noted that it might have been a candidate for determination as a preliminary issue, as has been done in some other cases, but none of the parties suggested or sought it.

29. At [105]-[122], the judge addressed the issue of standing. There was a sub-issue as to the validity of the appointment of the claimants as trustees, which the judge resolved in their favour. The claimants accepted that they could not show at the time of the hearing that they were the legal owners of shares in Tellisford. He rejected the claimants' submission that they were, for the purposes of standing, beneficial owners of the shares.

30. The judge held that the claimants were not members of Tellisford and that accordingly they did not have standing to bring the claims. Their claim to be registered as members would "fall to be decided in the Rectification Claim by reference to the state of formal transfer instrumentation and supporting evidence pertaining at the relevant time". He continued:

> "121. In light of my conclusion on the threshold question of standing, the remaining issues do not immediately or necessarily arise for determination. That said, they were all fully canvassed at the hearing and, in light of what I say at the end of this judgment about the appropriate form of order to be made on the present application, their determination at this stage may have practical utility.
>
> 122. The premise for the remaining analysis, contrary to my conclusion on the standing issue by reference to the current state of affairs, is that Boston are treated as having sufficient interest in the relevant Tellisford shares."

31. The judge proceeded to consider the other issues and decided most of them in favour of the claimants. In conclusion, he said:

> "163. But for the current position on standing, I would have granted permission to Boston to pursue this derivative action in respect of all four heads of claim…
>
> 164. There was some discussion towards the conclusion of the hearing as to whether it might be appropriate to stay or adjourn the disposal of the permission application in the event that I were to conclude, as I have, that Boston currently lack sufficient standing in this matter, i.e. in order to give Boston an opportunity to pursue the Rectification Claim and/or seek

> permission to add another claimant in these proceedings. Boston's counsel suggested as a fall-back that the court could grant permission conditional upon a successful outcome in the Rectification Claim. I can see sense in that as a way forward.
>
> 165. I will hear argument from the parties as to the appropriate form of order to make consequent upon handing down of this judgment, including as to costs"

The second judgment

32. A further hearing to consider the terms of the order and other consequential matters took place on 21 May 2020 and, having circulated a draft judgment the following day, the judge handed down judgment on 26 May 2020.

33. In his second judgment, the judge identified as the relevant issue whether the court had power and, if so, whether it should exercise the power, to grant conditional permission where (a) the court had concluded that the claimants lack standing but that the court would otherwise give unconditional permission and (b) the claimants were actively pursuing a separate legal process to rectify the share register which, if successful, would confer standing. He referred to the claimants having, in these circumstances, "inchoate standing".

34. Having set out the background and referred in some detail to the rectification claim, the judge examined, first, whether the court had jurisdiction to grant conditional permission, by reference to CPR 19.9. He concluded that CPR 19 was to be read with CPR 3.1(3) which provides that:

> "When the court makes an order, it may (a) make it subject to conditions, including a condition to pay a sum of money into court; and (b) specify the consequences of failure to comply with the order or a condition."

35. The judge said at [43] that there was no obvious reason why CPR 3.1(3) should not apply to the grant of permission for a derivative claim and that "[a]s a matter of jurisdiction the court must have power to grant conditional permission to pursue a derivative claim, for example, security for costs or undertakings provided by the claimant as the price for permission".

36. The judge turned to whether he should exercise his discretion to grant permission subject to the condition that the claimants become registered as members of Tellisford. He was satisfied that the claimants had at least a good arguable case for an order for retrospective rectification of the register. He decided that the claimants' election not to seek a stay or adjournment of the permission application, while they pursued the rectification application, did not preclude the court from giving conditional permission.

37. He accordingly made the order under appeal.

38. On this appeal, the claimants sought to contest the judge's finding that they lacked standing. They filed a respondent's notice, seeking to uphold the judge's decision on

different or additional grounds, namely either (i) that the judge, having held that the claimants had an equitable interest in the A ordinary shares, should have held that such interest was sufficient to give them standing, or (ii) that they enjoyed standing by virtue of the stock transfer form relating to 5 B ordinary shares executed by Mr Maughan in favour of "the trustees of the Erutuf Trust".

39. Although we heard submissions on these points, they do not need to be decided, in view of the retrospective effect of the rectification order. Further, I do not consider that they properly formed the subject of a respondent's notice upholding the decision below. The claimants advanced these arguments before the judge. They were arguments which, if correct, would have entitled the claimants to an unconditional grant of permission. It was because the judge rejected them that he made the conditional order. They are not grounds which support the order made by the judge. Permission to cross-appeal on these grounds was not sought or given.

Discussion

40. The judge's approach of asking, first, whether the court had jurisdiction to grant conditional permission and, second, whether he should exercise his discretion to grant conditional permission had the disadvantage of deflecting him from what I consider to be the central question, that is, whether it can ever be right to grant conditional permission in favour of a claimant who lacks standing, save perhaps in the most exceptional circumstances.

41. For my part, I do not consider that the question of jurisdiction takes one very far. While there is nothing in the statutory regime or in CPR 19 that provides any encouragement for a conditional grant of permission, it would be a strong thing to say that the High Court, a court of unlimited jurisdiction, wholly lacked jurisdiction to attach a condition to the grant of permission. However, I am very doubtful that any power to do so derives from CPR 3.1(3) which is concerned only with case management, not with whether a case can be maintained at all. That does not, however, help to determine whether it can be right to grant conditional permission, except perhaps (as I have said) in exceptional circumstances.

42. The claimants' standing to bring the present proceedings is, as the judge correctly said, "the threshold question". As the claimants were not members of Tellisford, and did have not standing on any other basis, they had no basis in law on which to bring the proceedings. It is only if a claimant has standing, that the issues as to whether the court should give permission for the proceedings to continue arise, however strong on those issues the claimant's case may appear to be. Unless a claimant can cross the threshold, there is no warrant for examining and deciding the issues that are contingent upon it. As Henderson LJ observed in argument, by granting permission, albeit conditionally, the judge was accepting that there was a state of facts to justify the grant of permission at that very point, but that was to beg the question of whether there was standing to make the application at all.

43. There is a further substantial reason for deciding the threshold issue before deciding whether permission should be granted. The judge himself remarked in his second judgment at [39] that the starting point must be that the court's power to grant permission is exercisable in the circumstances pertaining at the time that such permission is sought or granted. The grant of permission is a single step, requiring the

determination or assessment of a number of issues. It is therefore not only appropriate but also necessary that permission is not granted until all those issues have been determined. An issue like standing can quite properly be taken as a preliminary issue, leaving the assessment of the other elements to a later time (assuming only no change in standing in the meantime). To determine all the issues, but leave standing undecided, is to invite the problem that the assessment of those issues might be different by the time that standing had been determined.

44. This approach does not have the consequence that the only course open to the judge was to refuse permission and strike out the action. As both parties agreed before us, the judge could have stayed or adjourned the application for permission pending the hearing of the rectification application, much as Briggs J did in *Re Starlight*. In that case, an unfair prejudice petition was presented by a person who was not a member and therefore lacked standing under section 459 of the Companies Act 1985. Briggs J stayed the petition to enable the petitioner to apply for retrospective rectification of the register of members. I am unable to see any material difference between that case and the present. In both cases, the person issuing proceedings lacked the capacity to do so, in the one case under the applicable statutory regime and in the other case under the applicable common law rules. Contrary to the submissions for the claimants, the order for conditional permission made by the judge was not, for the reasons given above, a means of achieving the same result.

45. In my judgment, the grant of conditional permission was not a course which was properly open to the judge and the appropriate course was to adjourn or stay the permission application pending determination of the rectification application within a reasonable time. There are no circumstances in the present case which would have made this an inappropriate order to make.

Conclusion

46. If, in any future case, a similar situation should arise, the court should not make a conditional order for permission but should adjourn or stay the permission application, pending (within a reasonable time) determination of an application for rectification of the register of members or the taking of such other steps as may be necessary to give the claimant standing.

47. I would therefore set aside the judge’s order giving conditional permission and, in view of the order for retrospective rectification, substitute an order giving unconditional permission.

Lord Justice Warby:

48. I agree.

Lord Justice Henderson:

49. I also agree.

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IN THE GRAND COURT OF THE CAYMAN ISLANDS FINANCIAL SERVICES DIVISION

CAUSE NO: FSD 106 OF 2017 (NSJ)

BETWEEN:

TOP JET ENTERPRISES LIMITED

Plaintiff

AND

SINO JET HOLDING LIMITED

First Defendant

JET MIDWEST, INC

Second Defendant

JUDGMENT

Appearances:	**Colin McKie QC and Paul Smith of Maples and Calder acting for the Plaintiff**
	No appearance for the First Defendant or Second Defendant
Hearing:	**8 December, 2017**
Draft judgment circulated:	**18 January, 2018**
Date of judgment:	**19 January, 2018**

HEADNOTE

Derivative action – derivative action brought in Missouri – whether the provisions of the Grand Court Rules relating to the need for leave to continue derivative actions and for representative actions apply in the case of foreign derivative actions – whether the Court can and should grant declaratory relief concerning the right of a shareholder in a Cayman company to bring a foreign derivative action

Introduction

1. This case concerns the law and procedural rules applicable to derivative proceedings commenced abroad (outside Cayman) by a shareholder of a Cayman company (in the name and on behalf of that company) against a defendant resident in the foreign jurisdiction. It raises the question of whether leave to continue is required from this Court in such a case (after the defendant in the foreign proceedings has defended the action) and, if leave is not required, whether and in what circumstances this Court should entertain an application by the shareholder seeking to establish its right under Cayman law to bring the derivative action in the foreign court.

2. Top Jet Enterprises Limited (***Top Jet***) is a shareholder of a Cayman company called Sino Jet Holding Limited (***Sino Jet***). Top Jet has commenced proceedings in State Court in Missouri, USA in the name and on behalf Sino Jet against Jet Midwest, Inc. (***Jet Midwest***). In the Missouri proceedings Jet Midwest has questioned and challenged Top Jet's standing to do so. That issue is to be dealt with by the Missouri court at trial but before trial Top Jet has issued a separate application in this Court. In that application Top Jet seeks leave to continue the Missouri proceedings, if leave is required, and a declaration that under Cayman law it is entitled to bring a claim against Jet Midwest derivatively. Jet Midwest has been made a party to and served with the Cayman application but has chosen not to participate in these proceedings. I have concluded, for the reasons set out below, that:

   (a). leave to continue the Missouri proceedings is not required.

   (b). I should make the orders sought by Top Jet declaring that if the facts and matters set out in its pleading in the Missouri proceedings (a petition) are proven at trial then Top Jet is entitled under Cayman law to bring the Missouri proceedings against Jet Midwest on Sino Jet's behalf.

3. I have considered carefully whether Top Jet should be required to establish its right to bring the Missouri proceedings derivatively in the Missouri court and whether a separate application to this Court should be permitted. On balance I have concluded that in the circumstances of this case it is appropriate that the application be made (and served out of the jurisdiction) and that the relief sought be granted. This is in part because this is the first time, as far as I am aware, that this issue has been dealt with by

this Court and there is a question as to whether leave from this Court is necessary even if the Missouri court does not require it, so that a decision of this Court is needed. It is also in part because Top Jet is seeking to exercise and enforce its Cayman law right as a shareholder of a Cayman company to be allowed to act in the name and on behalf of the company (in circumstances where it can establish that an exception to the rule in *Foss v Harbottle* (1843) 2 Hare 461 applies) and that issue particularly concerns the other shareholder of Sino Jet and Sino Jet's directors such that it is closely connected with this jurisdiction. I have, as I explain below, been concerned that the declarations are being sought by reference to assumed facts and without the benefit of the evidence in support of and opposition to the Missouri claim, and to ensure that any orders I make do not interfere with the Missouri proceedings. But on balance I have concluded that I should nonetheless make the declaration outlined above and am satisfied that the orders I make will not interfere with the Missouri proceedings. It will be a matter for the Missouri court to decide whether Cayman law applies to the issue of Top Jet's standing (it appears that it may well do so) and the effect in the Missouri proceedings of the orders I have made and my decision.

The Missouri Proceedings, Sino Jet and the other parties involved

4. As I have explained Top Jet commenced the proceedings against Jet Midwest in State Court in Missouri, USA. Top Jet is a member of Sino Jet and owns fifty per cent of Sino Jet's shares. The other fifty per cent is owned by Skyblueocean Limited (***Skyblueocean***) a company incorporated in the British Virgin Islands. Skyblueocean is said to be owned and controlled by Mr. Paul Kraus (***Mr. Kraus***) and his sister. Mr. Kraus is a director of both Skyblueocean and Sino Jet. Skyblueocean has appointed three of the six directors of Sino Jet of whom Mr. Kraus is one. Sino Jet was a party to a consignment agreement entered into in December 2015 (the ***Consignment Agreement***) with Jet Midwest, a company incorporated in the State of Kansas, USA but with its principal place of business in Kansas City Missouri. The Consignment Agreement was governed by New York law. Top Jet asserts that Jet Midwest is in breach of the Consignment Agreement and is liable to account, and pay damages, to Sino Jet, that Jet Midwest is owned and controlled by Mr. Kraus and his sister and that Mr. Kraus and the other directors of Sino Jet appointed by Skyblueocean, in breach of duty, have failed to act so as to cause Sino Jet to enforce, and will prevent Sino Jet from enforcing, its rights and recovering its property from Jet Midwest. Accordingly, Top Jet argues that it is entitled as a matter of Cayman law to issue derivative proceedings, on behalf of all Sino Jet's shareholders and in the name of Sino Jet, against Jet Midwest.

But since Jet Midwest is located in Kansas City Missouri, it has been necessary to issue proceedings there, which was done by way of a first amended petition dated 5 May 2017 (the ***Petition***).

5. The Petition was expressed to be issued by Top Jet derivatively on behalf of Sino Jet. In the Petition the following facts and matters are averred and relied on:

(a). that under Sino Jet's articles of association board approval is required before Sino Jet can commence proceedings against Jet Midwest. Such approval requires a vote of the majority of the board (paragraphs 64 and 65).

(b). a majority in favour of bringing proceedings cannot be obtained because three of the six members of the board (Mr. Kraus, Mr. Woolley and Ms. Lumley) have an interest in shielding Jet Midwest and therefore have a conflict of interest, have turned a blind eye to Jet Midwest's failure to perform its obligations under the Consignment Agreement and would block Sino Jet from enforcing the Consignment Agreement (paragraphs 66 and 67).

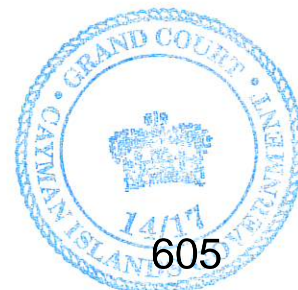
(c). furthermore, Sino Jet's articles also provide that Sino Jet cannot commence any material litigation in which the amount in dispute is or could reasonably be expected to exceed US$300,000 without the approval of the Sino Jet board including the affirmative vote of at least one director appointed by Skyblueocean, and the dispute with Jet Midwest satisfies this test (paragraph 69).

(d). Top Jet cannot replace the directors appointed by Skyblueocean because they can only be removed and replaced by Skyblueocean (paragraph 68).

(e). accordingly Sino Jet is effectively prevented from taking action to protect its interests and rights under the Consignment Agreement (paragraph 70).

(f). Skyblueocean can prevent Sino Jet from enforcing its rights only by misusing its *de facto* control of Sino Jet and by causing the directors it has appointed and controls to breach their fiduciary duties to the Sino Jet shareholders as a whole for the benefit of Jet Midwest and at Sino Jet's expense (paragraph 82)

(g). a demand for the board to approve the commencement of proceedings against



Jet Midwest would be futile because the directors appointed by Skyblueocean are unable to exercise independent and disinterested judgment on the matter (paragraph 83).

6. On 5 June, 2017 Jet Midwest filed its answer (the ***Answer***) to the Petition and in addition to denying the claims made against it asserted by way of affirmative defence (in paragraph 95 of the Answer) that although the claims for relief alleged in the Petition were "*a purported shareholder derivative action, there* [had] *been no compliance with the* [Sino Jet] *articles of association much less the requirements of the laws of the Cayman Islands prior to the initiation of* [the Petition]."

The Cayman proceedings

The Original Originating Summons

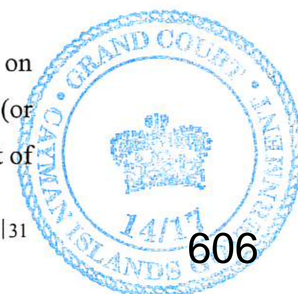
7. Shortly before the filing of the Answer, on 25 May 2017, Top Jet had issued an originating summons (the ***Original Originating Summons***) in this Court with itself as plaintiff and Sino Jet as respondent seeking leave pursuant to GCR O.15, r.12A(2) to continue the proceedings commenced by the Petition (the ***Missouri Proceedings***) and an order that Top Jet be indemnified out of the assets of Sino Jet in respect of its costs incurred and to be incurred in the Missouri Proceedings and these proceedings. The evidence filed in support of the Original Originating Summons included an affidavit sworn by Constance Meng, a director and the chairman of Sino Jet (who had been appointed by Top Jet).

8. In the Original Originating Summons Top Jet sought the following orders:

(a). pursuant to GCR O.15, r.12A(2) a declaration that Top Jet shall have leave to continue the Missouri Proceedings derivatively on behalf of Sino Jet; and

(b). an order that Top Jet be indemnified out of the assets of Sino Jet in respect of the costs incurred and to be incurred in the Missouri Proceedings and in the Cayman proceedings.

9. The Original Originating Summons was served on Sino Jet on 1 June 2017 and on Skyblueocean on 1 July. No response having been received from Sino Jet (or Skyblueocean), and following the expiry of the time for filing an acknowledgement of

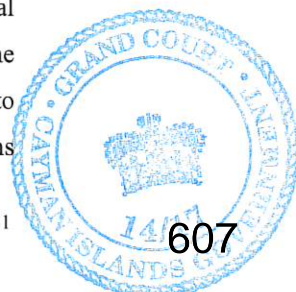


service, on 18 July, 2017 Top Jet issued a summons for directions seeking leave to adduce expert evidence and a trial date. Top Jet sought leave to adduce expert evidence from Mr. Daniel Blegen (***Mr. Blegen***) as to matters of New York and Missouri law as set out his first affidavit sworn on 22 June 2017 (***Mr. Blegen's First Affidavit***) and from Mr. Kenneth Yormark (***Mr. Yormark***) as to forensic accounting matters as set out his first affidavit sworn on 10 July 2017 (***Mr. Yormark's First Affidavit***). Mr. Blegen's evidence related to the law governing certain issues arising and the prospects of success of Sino Jet's claim in, and Top Jet's standing to bring, the Missouri Proceedings. Mr. Yormark's evidence related to the dealings between Sino Jet and Jet Midwest and the operation of the Consignment Agreement (for the purpose of establishing that Jet Midwest had an outstanding obligation to account to Sino Jet for proceeds of equipment sold by Jet Midwest on Sino Jet's behalf).

The 7 September hearing of the summons for directions

10. The hearing of the summons for directions took place before me on 7 September. At the hearing I expressed some concerns as to the basis on which Top Jet was seeking relief from this Court and in particular, leaving aside the issues of substantive law to which the Original Originating Summons gave rise, the fact that Jet Midwest had not been made a party and given an opportunity to oppose the application. I noted that, without wishing to determine at that stage the question of whether the Court had jurisdiction to deal with and grant leave to continue a foreign derivative claim, it would be odd if there were jurisdiction to do so but that the defendant to the foreign proceedings was not, as would be the case in a derivative claim to which O.15, r.12A(2) applied, given an opportunity to challenge the claimant's standing and if separate proceedings in this jurisdiction were needed, made a party to and given notice of the Cayman proceedings. I said that, as a minimum, it seemed to be necessary and right that at that stage Jet Midwest be made a party to these proceedings and served out of the jurisdiction, if otherwise permissible, so that it had the opportunity to participate and raised any objections it might have.

11. In light of and in response to these concerns, counsel for Top Jet, Mr. Colin McKie QC of Maples and Calder, made an application at the hearing (in reliance on the evidence filed in support of Top Jet's application) for leave first, to amend the Original Originating Summons to add Jet Midwest as the second defendant and to add in the alternative a claim that Top Jet be appointed as representative of Sino Jet pursuant to GCR O.15, r.12(1) and second, to serve the amended Original Originating Summons



out of the jurisdiction on Jet Midwest in the State of Kansas, United States of America or elsewhere in the United States of America. The alternative claim pursuant to GCR O.15, r.12(1) sought an order that Top Jet be appointed as representative of Sino Jet in the Missouri Proceedings and in that capacity that Top Jet should have leave to continue the Missouri Proceedings (and that Top Jet be indemnified out of the assets of Sino Jet in respect of the costs of both the Missouri Proceedings and the Cayman proceedings).

The application for leave to serve out

12. Leave to serve out was sought pursuant to GCR O.11, rule 1(1)(c). This rule (applied to an originating summons by GCR O.11, r.9) permits service out in a case where "*the claim is brought against a person who has been or will be duly served within or out of the jurisdiction and a person out of the jurisdiction is a necessary or proper party thereto.*" Mr. McKie, in light of and adopting my preliminary views regarding the need for the defendant to the proceedings being brought derivatively in another jurisdiction to be given the opportunity to participate in the Cayman proceedings and to raise any challenges to standing or other objections which it considered to be relevant, submitted first that Jet Midwest was a necessary party to Top Jet's originating summons and second that the other requirements for the granting of leave to serve the amended Original Originating Summons out were satisfied in this case. He submitted that these other requirements were that Top Jet could show that the claim against Jet Midwest had a reasonable prospect of success and that the case is a proper one for service out of the jurisdiction (because, inter alia, Cayman is the appropriate forum in which to hear the action).

13. It seemed to me that it was appropriate to grant leave to serve the amended Original Originating Summons out of the jurisdiction:

(a). while proceedings in Cayman (as the country of incorporation of the company concerned) to establish and declare a shareholder's right to bring a derivative claim in another jurisdiction will not always be necessary, justified or appropriate, they may be and in this case they are.

(b). where the derivative action is being litigated in another jurisdiction the foreign court has the conduct of the action and the question of whether the action has been properly constituted and commenced is a matter for the foreign court. Any challenge to the standing of the shareholder who has commenced the action on

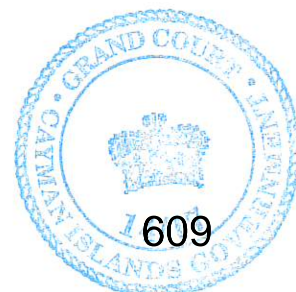
the company's behalf will be made in the foreign court. To the extent that the foreign court applies Cayman law to the standing issue (in determining whether the action has been properly constituted and commenced), one would expect that it would be able to deal with the issue with the benefit of expert evidence on Cayman law. To the extent that the foreign court applies its own or another law the position under Cayman law will be irrelevant.

(c). in the present case Jet Midwest has put in issue in the Answer Top Jet's right to bring the Missouri Proceedings. It has asserted that there has been a failure (by Top Jet) to comply with Cayman law prior to the initiation of the Missouri Proceedings. Jet Midwest has, however, not made an application in the Missouri court (assuming it could do so) or in this Court for an order requiring Top Jet to terminate and withdraw the Missouri Proceedings. It is content to leave the issue to be determined at trial.

(d). Top Jet is, however, not content to leave the issue until the trial of the Missouri Proceedings. The principal reason for this is that, if the Missouri court decides to apply Cayman law including GCR O.15, r.12A(2) to the issue of Top Jet's right to commence and continue the Missouri Proceedings on behalf of Sino Jet, and if GCR O.15, r.12A(2) applies to the Missouri Proceedings such that leave from this Court is required once Jet Midwest filed the Answer, then Top Jet would need an order from this Court granting leave in order to be able to continue the Missouri Proceedings to trial. Otherwise Top Jet could find that when it got to trial Jet Midwest would be able to say that Top Jet had no right under Cayman law to continue the Missouri Proceedings.

(e). accordingly, Top Jet needs to establish whether leave from this Court is needed and if it is to apply for and obtain leave to continue the Missouri Proceedings. Paragraph 1 of the Original Originating Summons (and the Original Originating Summons as amended) sought such relief. It does so by seeking a declaration that Top Jet shall have leave to continue the Missouri Proceedings.

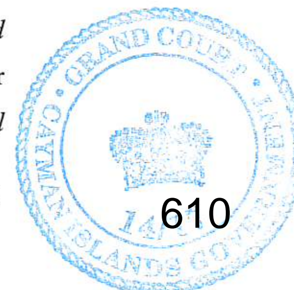
(f). in a domestic derivative action the company concerned needs to be made a defendant to the action so that it is bound by the judgment and receives any monies recovered (in circumstances where the action has not been authorised by the board or general meeting: see *Spokes v Grosvenor and West End Railway Terminus Hotel Co Ltd* [1897] 2 QB 124). Other parties against whom relief is



sought for wrongs done to the company are also joined as other defendants. The application for leave is then made by the plaintiff in the existing proceedings after the other defendants have given notice of intention to defend (in accordance with GCR O.15, r.12A(2)). This is obviously not possible in the case of a foreign derivative claim as there are no proceedings already on foot before the Court. If leave is to be sought in this jurisdiction, and the issue of the right of the shareholder suing derivatively brought before this Court, then it is necessary to commence a new set of proceedings by a suitable form of originating process. In the present case, Top Jet issued the Original Originating Summons so as to seek an order granting it leave to continue the Missouri Proceedings. Initially Sino Jet was joined as the defendant but at the time of the application for leave to serve out Top Jet had sought and been granted leave to amend the Original Originating Summons to join Jet Midwest as the second defendant.

(g). accordingly the claim for which leave to serve out was sought was the claim for leave to continue the Missouri Proceedings, originally commenced as a free-standing originating summons against (and served on) Sino Jet to which Jet Midwest was now added as a second defendant. It seemed to me that Top Jet could properly commence and justify such an application against Sino Jet and that Jet Midwest was a necessary or proper party to such an application.

(h). Top Jet's claim (in paragraphs 1 and 2 of the Original Originating Summons) is based on a right under Cayman law, namely its equitable right as a shareholder (where an exception to the rule in *Foss v Harbottle* can be established) to invoke the equitable jurisdiction of the Cayman Court to prevent a wrong to Sino Jet going unremedied. That right is usually enforced or exercised by recourse to the procedural device of allowing the shareholder to bring domestic proceedings in the name of the company. But in a case in which the relevant defendant is resident in another jurisdiction and has to be sued there I see no reason why the right cannot be enforced or recognised in a separate proceeding in this jurisdiction. I note the view expressed by Mr. Justice Lawrence Collins in *Konamaneni v Rolls Royce Industrial Power (India) Ltd* [2002] 1 BCLC 336 (***Konamaneni***) that: "[even though] *for purely ... domestic purposes the exceptions to the rule* [in *Foss v Harbottle*] *have been regarded as a procedural device, I do not consider that in the international context* [for the purpose of characterisation in a private international law context] *their real*

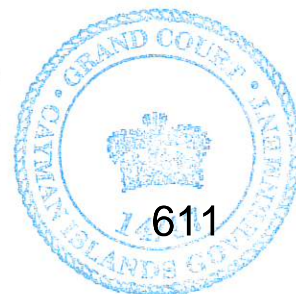


nature is procedural. They confer a right on shareholders to protect the value of their shares by giving them the right to sue and recover on behalf of the company. .." Top Jet is to be treated as enforcing such a right primarily against Sino Jet and its directors and other shareholder. Even though the derivative action itself is taking place in another jurisdiction Top Jet can seek to enforce its rights by asking this Court to declare that it is entitled to act on behalf of Sino Jet, a Cayman company, and if necessary to make an order appointing Top Jet as Sino Jet's representative for the purpose of conducting the Missouri Proceedings. In such a case the Cayman Company concerned is a proper party and so is the third party against whom the company has a claim.

(i). I would add that I have also considered the following statement made by Browne-Wilkinson LJ in *Nurcombe v Nurcombe* [1985] 1 WLR 370, 378:

> "*The Juristic basis of this principle* [the exceptions to the rule in Foss v Harbottle allowing a minority shareholder to sue in the name of the company] *(which is applicable in many Jurisdictions in the United States of America) is not clear. In the United States it has apparently been rationalised by saying that a minority shareholder's action is in fact two actions, one a personal action by the minority shareholder against the company for its failure to enforce the company's rights, the other by the company against the wrongdoer. Without expressing any view on the correctness of this analysis (which was not fully examined in argument), I do not think it is necessary to adopt such analysis in the present case. Since the wrong complained of is a wrong to the company, not to the shareholder, in the ordinary way the only competent plaintiff in an action to redress the wrong would be the company itself. But, where such a technicality would lead to manifest injustice, the courts of equity permitted a person interested to bring an action to enforce the company's claim. The case is analogous to that in which equity permits a beneficiary under a trust to sue as plaintiff to enforce a legal right vested in trustees (which right the trustees will not themselves enforce), the trustees being joined as defendants. Since the bringing of such an action requires the exercise of the equitable Jurisdiction of the court on the grounds that the interests of justice require it, the court will not allow such an action to be used in an inequitable manner so as to produce an injustice.*"

But it does not seem to be right that the only remedy available to a shareholder who establishes an exception to the rule in *Foss v Harbottle* is to bring the



derivative claim itself, such that if the derivative claim has to be brought in another jurisdiction there is no ability to seek relief from this Court. The substance of the matter is that a shareholder in such circumstances is to be permitted to take action on behalf of the company to enforce the company's rights and if the shareholder needs to assistance of this Court to do so the Court will hear its application and grant suitable relief.

(j). it therefore seemed to me to be both necessary and legitimate for Top Jet to formulate a claim for leave to continue the Missouri Proceedings as a claim against Sino Jet and to have Jet Midwest joined as a necessary or proper party to the application. Sino Jet needed to be a party as defendant since Top Jet was seeking relief binding on it (Top Jet was seeking to have its right to act on behalf of Sino Jet confirmed). Accordingly, there was a real issue between Top Jet and Sino Jet. Jet Midwest was a necessary or proper party since it would be affected by the granting of leave and a confirmation of Top Jet's authority to continue the Missouri Proceedings and should, as a matter of procedural fairness and justice, be given an opportunity to oppose the application. Both Sino Jet and Jet Midwest needed to be parties and given an opportunity to participate in order to be able to deal properly with the application for leave.

(k). it seemed to me that a similar analysis could be applied to Top Jet's alternative claim, for which permission to amend the Original Originating Summons had been given, for confirmation that it could act, and continue to act, as the representative of Sino Jet (and the other shareholder of Sino Jet) as set out in paragraph 2A of the Original Originating Summons as amended.

(l). it also seemed to me that Top Jet's evidence demonstrated both that the claim against Jet Midwest had a reasonable prospect of success and also that its claim that leave be granted (or that leave was not needed) had a reasonable prospect of success. In a case in which there was an application for leave to serve out a claim which itself sought leave to continue and confirm Top Jet's authority to continue the Missouri Proceedings, it was appropriate to have regard both to the prospects of Top Jet demonstrating that it should be allowed to continue (and not required to withdraw) the Missouri Proceedings and of Sino Jet succeeding in the Missouri Proceedings. After all, the Court, in the case of a domestic derivative action, is required at the leave stage under RSC O.15, r.12A(2) stage (and under the practice in existence before the adoption of that

rule where there was a challenge to the standing of a shareholder to bring the derivative action) to consider the derivative claim's prospects of success in order to control derivative claims and ensure that shareholders were not able to continue with and defendants were not forced to defend frivolous or otherwise unmeritorious claims.

(m). I did consider whether it Top Jet was able to establish that this was a proper case for service out of the jurisdiction (and whether Cayman is the appropriate forum in which to hear Top Jet's claim). I considered whether it might be appropriate to refuse leave to serve out so as to require the issue of Top Jet's standing to commence and continue the Missouri Proceedings including the leave issue to be dealt with in due course within those proceedings. I was conscious that by granting leave to serve out Jet Midwest would be put to the trouble and expense of having to appear in this Court if it wished to oppose the making of the orders sought by Top Jet in this Court. It would mean that there would need to be two sets of proceedings. I was also conscious (i) that if Jet Midwest chose not to participate in proceedings in this jurisdiction there would be an issue as what effect an order of this Court would have in the Missouri Proceedings and (ii) of the need to avoid giving the impression that this Court was seeking in any way to interfere with the Missouri Proceedings and the decision of the Missouri court.

(n). however, there were a number of reasons why it seemed to me that this was a proper case for service out. First, as I have noted, one issue raised by Top Jet's application was whether leave from this Court was needed in any event (and this is a novel issue which has not been dealt with in any reported decision by this Court). This is a matter which cannot definitively be dealt with by the Missouri court and which Top Jet had a legitimate interest in having adjudicated by this Court before a trial in Missouri. Secondly, the issues raised by paragraphs 1, 2 and 2A of the Original Originating Summons, as amended, are governed by Cayman law (see Lawrence Collins J's analysis of the question of the law governing derivative claims in *Konamaneni*) and, since they relate to the governance of a Cayman company and who is to be treated as being able to act on its behalf, are closely connected with this jurisdiction (and can conveniently be dealt with by this Court). It is to be hoped that the Missouri court will at least find the decision of this Court on Cayman law issues helpful and persuasive even if Jet Midwest has decided not to participate in the Cayman

proceedings and if it this Court's judgment is not technically enforceable in Missouri (about which I make no comment). Thirdly, while it was possible for the Missouri court to deal with some of these issues based on expert evidence of Cayman law, the expert evidence filed by Top Jet in support of the Original Originating Summons demonstrated that there were a number of uncertainties as to how the Missouri court would deal with the issue of Top Jet's standing and right to bring the Missouri Proceedings in the name of Sino Jet. The expert evidence of Missouri law filed by Mr. Blegen was that the substantive and procedural law to be applied by the Missouri court was not clear. It was not clear whether the Missouri court would apply Cayman law or Missouri law to the standing issue or whether the Missouri court would conclude that the requirements under Cayman law for leave to continue the proceedings were inapplicable (I would note that the position on whether Cayman law requirements for leave are to be applied in Missouri has subsequently and recently been clarified by a decision of the New York Court of Appeals, handed down on 20 November 2017, in *Davis v Scottish Re* in which that court decided that leave from this Court was not required to continue derivative proceedings brought in New York because GCR O.15, r.12A(2) did not apply to proceedings brought outside Cayman and in any event the requirement for leave being an aspect of the procedural law of Cayman would not be applied in New York – but it remains to be seen whether the Missouri court will follow this approach).

(o). it may be that in other cases, once it is authoritatively established in this Court that leave is not required for a foreign derivative action, it would be appropriate to refuse leave to serve out Cayman proceedings seeking a separate determination by this Court of the shareholder's right to bring and continue the foreign proceedings in a case in which the expert evidence establishes that the foreign court will be able to deal with the standing issue and can conveniently do so based on evidence of Cayman law. The foreign court might well then be the more appropriate forum.

(p). finally I would add that even though the focus of the leave to serve out analysis needs to be on Top Jet's claim to be able and for relief allowing it to act on behalf of Sino Jet in the Missouri Proceedings it seemed to me that the Court should also consider the basis of the underlying claim (against Jet Midwest) and whether Sino Jet's claim has a reasonable prospect of success. I was

satisfied on the basis of the evidence, including the expert evidence, filed in support of the Original Originating Summons, that this requirement was established for the purpose of the leave to serve out application.

14. The order granting leave to amend the Original Originating Summons and to serve it out of the jurisdiction was made on 14 September. The amended Original Originating Summons (the ***Amended Originating Summons***) was served on Sino Jet on 21 September and on Jet Midwest on 29 September. No acknowledgement of service was filed or other response received from Sino Jet, Jet Midwest or Skyblueocean.

Top Jet's application to re-amend the Amended Originating Summons

15. The Amended Originating Summons was listed to be heard on 8 December. At the hearing Mr. McKie applied for leave to re-amend the Amended Originating Summons to include a claim for a further declaration in the following terms.

16. In addition to its application for leave under GCR O.15, r.12A(2) and to be appointed a representative of Sino Jet under GCR O.15, r.12(1), Top Jet, in the alternative, sought a declaration (in paragraph 1A of the draft re-amended Amended Originating Summons) that:

(a). the facts and matters set out in the Petition if proven at trial, constitute a fraud on the minority in terms of such exception to the rule in *Foss v Harbottle* (1843) 2 Hare 461 as set out in *Prudential Assurance Co Ltd (No 2)* [1982] Ch 204.

(b). the cause of action brought in the Missouri Proceedings as set out in the Petition is a cause of action that may be pursued derivatively as a matter of Cayman Islands law.

(c). if, as a matter of Missouri law, Cayman Islands law governs the question, Top Jet had standing to commence and to continue the Missouri Proceedings.

17. This amendment was needed to deal with the possibility that neither GCR O.15, r.12A(2) or GCR O.15, r.12(1) applied to a case in which the underlying derivative claim was commenced in another jurisdiction and therefore there were no proceedings in Cayman within which leave could be sought or a representative appointed. At the hearing of the summons for directions on 7 September I had indicated that my

preliminary view was that this seemed to me to be strongly arguable. The relief sought by way of the re-amendment was, in substance, a reformulation of the declaratory relief already sought (without the need for any further evidence) since it authorised the commencement and continuation of the Missouri Proceedings by Top Jet on behalf of Sino Jet, albeit that the basis for such authorization would not be GCR O.15. For this reason I am prepared to grant the application to re-amend the Amended Originating Summons (I refer to the originating summons as so re-amended as the ***Re-amended Originating Summons***).

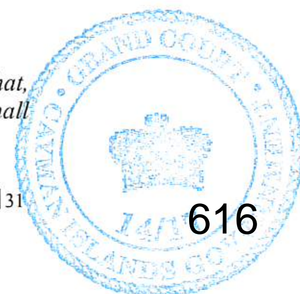
The relief sought by Top Jet – two separate bases

18. The Re-amended Originating Summons therefore sought relief on two separate bases. First, on the basis that GCR O.15, r.12A(2) or GCR O.15, r.12(1) applied in the present case even though there are no extant proceedings in Cayman within which leave to continue can be sought or a representation order made. Second, on the basis that even if these rules are inapplicable, the Court has jurisdiction to (and should) make a declaration to the effect that Top Jet is entitled to bring the Missouri Proceedings on behalf of Sino Jet (and if appropriate to authorise Top Jet to do so).

Does GCR O.15, r.12A(2) apply?

19. The material part of GCR O.15, r.12A(2) is as follows:

> *"(1) This rule applies to every action begun by writ by one or more shareholders of a company where the cause of action is vested in the company and relief is accordingly sought on its behalf (referred to in this rule as a "derivative action").*
>
> *(2) Where a defendant in a derivative action has given notice of intention to defend, the plaintiff must apply to the Court for leave to continue the action.*
>
> *………*
>
> *(4) Unless the Court otherwise orders, the application must be issued within 21 days after the relevant date, and must be served, together with the affidavit in support and any exhibits to the affidavit, not less than 10 clear days before the return day on all defendants who have given notice of intention to defend; any defendant so served may show cause against the application by affidavit or otherwise.*
>
> *(5) In paragraph (4), the relevant date means the later of –*
> *(a). the date of service of the statement of claim;*
> *(b). the date when notice of intention to defend was given, provided that, where more than one notice of intention to defend is given, that date shall*



be the date when the first notice was given.

(6) *Nothing in this rule shall prevent the plaintiff from applying for interlocutory relief pending the determination of an application for leave to continue the action.*

(7) *In a derivative action, Order 18, rule 2(1) (time for service of defence) shall not have effect unless the Court grants leave to continue the action and, in that case, shall have effect as if it required the defendant to serve a defence within 14 days after the order giving leave to continue, or with such other period as the Court may specify.*

(8) *On the hearing of the application under paragraph (2), the Court may –*
- (a) *grant leave to continue the action, for such period and upon such terms as the Court may think fit;*
- (b). *subject to paragraph (11), dismiss the action;*
- (c). *adjourn the application and give such direction as to joinder of parties, the filing of further evidence, discovery, cross examination of deponents and otherwise as it may consider expedient.*

(9) *If the plaintiff does not apply for leave to continue the action as required by paragraph (2) within the time laid down in paragraph (4), any defendant who has given notice of intention to defend may apply for an order to dismiss the action or any claim made in it by way of derivative action.*

(10) *On the hearing of such an application for dismissal, the Court may –*
- (a). *subject to paragraph (11), dismiss the action;*
- (b). *if the plaintiff so requests, grant the plaintiff (on such terms as to costs or otherwise as the Court may think fit) an extension of time to apply for leave to continue the action; or*
- (c). *make sure other order as may in the circumstances be appropriate.*

……."

20. In his written submissions Mr. McKie noted that the scheme of GCR O. 15, r. 12A was tied to the filing of the "writ", the "notice of intention to defend" and the "statement of claim". The time for service of a defence, which would ordinarily be within 14 days of the service of the statement of claim, was suspended until the Court granted leave to continue. He also noted that the forms and content of these documents were dealt with and prescribed by the GCR. He accepted that "*As a result, GCR O. 15, r. 12A seems inapposite to apply to foreign proceedings, particularly when those foreign proceedings do not employ documents named writs or notices of intention to defendant or statements of claim, as in the instant case where the Missouri Proceedings were commenced by* [the Petition], *being a document in the form that satisfies the rules of the Missouri Court for the commencement of proceedings in that forum.*" Nonetheless, he submitted that it was open to the Court to adopt a "*flexible and purposive interpretation of the relevant GCR rules*" and read the references to writ, notice of intention to defend, statement of claim and defence as applying to any document in the proceedings in which the underlying derivative action was being

conducted, in this case the Missouri Proceedings, which fulfilled the same function as the Cayman pleadings or documents. On that basis GCR O. 15, r.12A could accommodate and would apply to foreign derivative proceedings.

21. I do not accept that GCR O. 15, r. 12A can be interpreted and applied in this manner. The rule clearly contemplates and presupposes that the action by the relevant company against the relevant defendant which has been commenced by the relevant shareholder is being conducted before this Court so that the application for leave to continue the action can be made within that action and the Court can make orders regulating the future conduct of such action (for example, by making an order on the application of the defendant to dismiss the action). Furthermore the rule contemplates that the timetable of the action will be affected by the need for an application for leave. The procedural mechanism created by the rule only works where the derivative action has been issued in Cayman. In my view it can have no application to a foreign derivative action.

Does GCR O.15, r.12 apply?

22. GCR O.15, r 12 provides:

> *(1). Where numerous persons have the same interest in any proceedings, not being such proceedings as are mentioned in rule 13, the proceedings may be begun, and, unless the Court otherwise order, continued, by or against any one or more of them as representing all of as representing all except one or more of them.*
>
> *(2). At any stage of proceedings under this rule the Court may, on the application of the plaintiff, and on such terms, if any, as it thinks fit, appoint any one or more of the defendants or other persons as representing whom the defendants are sued to represent all, or all except one or more, of those persons in the proceedings; and where in exercise of the power conferred by this paragraph, the court appoints a person not named as a defendant, it shall make an order under rule 6 adding that person as a defendant.*
>
> *(3). A judgment or order given in proceedings under this rule shall be binding on all the persons as representing whom the plaintiffs sue or, as the case may be, the defendants are sued, but shall not be enforced against any person not a party to the proceedings except with the leave of the Court.*
>
> *(4). An application for the grant of leave under paragraph (3) must be made by summons which must be served personally on the person against whom it is sought to enforce the judgment or order.*

(5). *Notwithstanding that a judgment or order to which any such application relates is binding on the person against whom the application is made, that person may dispute liability to have the judgment or order enforced against him on the ground that by reason of facts and matters particular to this case he is entitled to be exempted from such liability.*

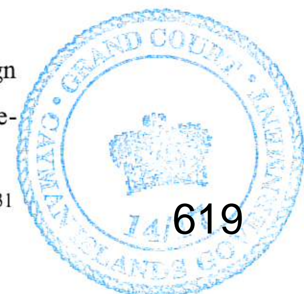
(6). *The Court hearing an application for the grant of leave under paragraph (3) may order the question whether the judgment or order is enforceable against the person against whom the application is made to be tried and determined in any manner in which any issue or question in an action may be tried and determined.*

23. As Mr. McKie pointed out, derivative actions in Cayman are brought in representative form. The title to the action states that the plaintiff is suing on behalf of himself and all other shareholders of the company other than a shareholder whose action is complained of and is a defendant (see *Gore Browne on Companies*, paragraph 28-6 as set out in the 4th supplement of April 1984). The main purpose of doing so is to allow other shareholders to take over the conduct of the action in the event that the shareholder initiating the derivative claim fails to prosecute it properly or otherwise withdraws. "*In a representative action an unnamed but represented plaintiff is a "party" .. thus where the named plaintiff withdraws from the proceedings the name of a previously unnamed but represented plaintiff may be added and the pleadings amended accordingly*." (*Gore Browne on Companies*, above paragraph 28-6).

24. But it seems to me that these rules and the procedural mechanism created thereunder for protecting and involving represented plaintiffs in the action and for allowing the shareholder initiating the derivative action to act in a representative capacity apply only to proceedings commenced in this jurisdiction. GCR O.15, r.12 refers to and regulates proceedings being conducted in this jurisdiction and gives the Court powers with respect to proceedings taking place before it. The GCRs cannot have been intended to apply to and regulate the conduct of foreign proceedings. Mr. McKie had acknowledged in his written submissions that applying GCR O.15, r.12 to foreign proceedings was not without difficulty and during his oral submissions, while not conceding the point, acknowledged the weakness of the argument.

What is the position where GCR O. 15, r. 12A and GCR O. 15, r. 12 do not apply?

25. So what is the position if, as I have held, GCR O.15 does not apply to a foreign derivative action? The relief sought by Top Jet in paragraphs 1, 2 and 2A of the Re-



amended Originating Summons cannot be granted. But can and should the Court grant the relief sought in paragraph 1A of the Re-amended Originating Summons?

26. It will be recalled that in paragraph 1A, Top Jet sought three declarations, namely that:

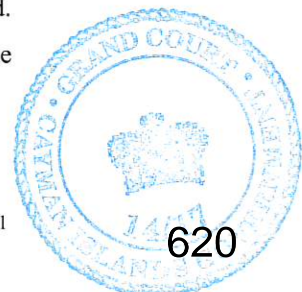
(a). the facts and matters set out in the Petition if proven at trial, constitute a fraud on the minority in terms of such exception to the rule in *Foss v Harbottle* (1843) 2 Hare 461 as set out in *Prudential Assurance Co Ltd (No 2)* [1982] Ch 204.

(b). the cause of action brought in the Missouri Proceedings as set out in the Petition is a cause of action that may be pursued derivatively as a matter of Cayman Islands law.

(c). if, as a matter of Missouri law, Cayman Islands law governs the question, Top Jet had standing to commence and to continue the Missouri Proceedings.

27. It seems to me that before or perhaps in addition to deciding whether the Court can and should make declarations in these terms I also need to consider whether even though GCR O. 15, r. 12A is not applicable, Top Jet nonetheless needs to apply for leave to continue the Missouri Proceedings? If there is a free-standing requirement for leave, outside and independent of the GCRs, then Top Jet would need to make and the Court will need to decide whether to grant leave.

28. It seems to me that there is no such a free-standing requirement. In the absence of a requirement imposed by the GCRs to seek leave in a case of a foreign derivative action, it does not seem necessary or appropriate for the Court to impose one. In the absence of an applicable rule, the position is similar to that which applied to domestic derivative actions before the adoption of GCR O. 15, r. 12A in 1995 (by the Grand Court Rules of 1995). The position before the adoption of GCR O. 15, r. 12A was considered recently in the Court of Appeal by Chadwick P in *Renova Resources Private Equity Fund v. Pallinghurst (Cayman) General Partners LP et al*, (Unreported, CICA, 12 September 2017). Chadwick P. stated that the practice for the control of derivative proceedings, prior to the introduction of GCR O. 15, r. 12A, was that the issue of derivative standing was for the defendant who could mount a challenge if he so wished. He would do so by bringing an application to strike out or for the determination of the plaintiff's standing as a preliminary issue. As Chadwick P explained (at [26]):



> "*but it is important to have in mind, first, that it* [Renova, the shareholder bringing a multiple derivative action] was not required to [seek leave to proceed with the derivative action] .. *under GCR O. 15, r. 12A (which, in the restrictive form in which that order had been made, had no application to multiple derivative actions) and, second, that there was no other rule of practice which required that leave was required to bring a multiple derivative action under the general law. It is clear, from the judgments in Waddington [[2009] 2 BCLC 82] and from the observations of Mr. Justice Briggs in Universal Project Management Services Ltd v Fort Gilkicker Ltd ..., that the practice under the general law in relation to the pursuit of derivative claims - which predated the introduction of GCR O. 15 r. 12A - was abrogated by that rule in relation to single derivative actions but continued to apply (after the introduction of that rule) in relation to multiple derivative actions. As Mr. Justice Ribeiro PJ pointed out in Waddington (at paragraphs 13 and 14 of his judgment):*
>
> > *"13 . . . Procedurally, there is no requirement at common law for a person seeking to sue derivatively first to obtain the leave of the court. . . .*
> >
> > *14 The time-honoured practice at common law is for the plaintiff to issue proceedings 'on behalf of himself and the other shareholders other than the defendants', naming the company on whose behalf the proceedings are brought as one of the defendants. A challenge to the plaintiff's locus generally takes the form of an application by the relevant defendants to strike out the claim or to have the court determine as a preliminary issue that the plaintiff has no locus to sue on the company's behalf"* [emphasis added]"

29. In the absence of a rule to the contrary, the position was that there was no requirement for the shareholder bringing the derivative claim to establish his entitlement to do so before commencing the action (or to seek leave to continue). The onus was on the defendant to challenge the right of the plaintiff by making an application to strike out or for the determination of a preliminary issue (see *Smith v Croft (No. 1)* [1986] 1 WLR 580 and *Renova v Gibertson* [2009] CILR 268 at [7]-[12]). The English Court of Appeal in *Prudential v Newman Industries (No.2)* [1982] 1 Ch 204 established the manner in which such a challenge was to be dealt with and the test to be applied. The plaintiff would be required "*to establish a prima facie case (i) that the company is entitled to the relief claimed and (ii) the action falls within the proper boundaries of the exception to the rule in Foss v Harbottle*". See also *Smith v Croft (No 2)* [1988] Ch 114 (***Smith v Croft (No 2)***).

30. In other words the defendant to the derivative action could and should raise any challenge to standing in the proceedings commenced against it in the manner appropriate to those proceedings. Where the challenge was made in Cayman proceedings that would need to be done, as I have explained, by an application to strike out or for the determination of a preliminary issue with a modification to the usual approach taken on such applications. As Knox J said in *Smith v Croft (No 2)* the Court

of Appeal had devised and the court should apply:

> "*a special form of procedure concerned with giving sensible operation to the rule in Foss v Harbottle and which is concerned with avoiding the Scylla and Charybdis on the hand of having a preliminary issue which effectively requires one to try the whole action where the rules serves no useful purpose and on the other side of the strait, of assuming that everything the plaintiffs allege is necessarily correct as a matter of fact, which is of course the technique the court adopts when it has was called a strict demurrer. The Court of Appeal has laid down a halfway house for this very special type of case, one in which the legal issues in this particular case are sufficiently well defined for the parties to be able to argue them ...*"

31. It seems to me that a similar analysis applies and a similar approach should be adopted in the case of a foreign derivative action. Where there is a foreign derivative action, so that there is no requirement under the GCR for leave, no leave is needed as a matter of Cayman law. The challenge to standing will need to be brought in the foreign proceedings and disposed of by the foreign court in accordance with its law and procedure. To the extent that it applies Cayman law to the standing point, the foreign court will determine what Cayman law issue will arise (for example whether the issue is whether under Cayman law the shareholder would be given leave to continue the derivative action or whether at trial, on the facts established at trial, the case falls within an exception to the rule in *Foss v Harbottle* so that the claim may properly be brought derivatively). There is no necessary role for this Court. While the Court exercises a supervisory jurisdiction with respect to derivative actions (see Lightman J in *Fraser v Oystertec plc* [2005] BIPR 389 at [29]) this does not seem to me to require or justify imposing an obligation on a shareholder to seek leave, even though doing so would bring the position with respect to foreign derivative actions into alignment with that applicable to domestic derivative actions. The defendant to the foreign derivative action is able to challenge standing in the foreign court and could, if it considered it to be necessary and justifiable, also apply to this Court for relief.

32. In the present case the challenge to Top Jet's standing to commence the Missouri Proceedings is, for obvious and proper reasons, raised by Jet Midwest in those proceedings. It will be a matter for the Missouri court in due course to adjudicate on that challenge and apply Cayman law or such other law as it considers to be applicable. Top Jet is seeking to establish in this Court whether as a matter of Cayman law Top Jet is required to obtain leave to continue the Missouri Proceedings and either to obtain leave if required or otherwise a confirmation, by way of declaration, that on the facts as pleaded in the Petition, *if proven at trial* it is entitled under Cayman law to bring the proceedings in the name and on behalf of Sino Jet.

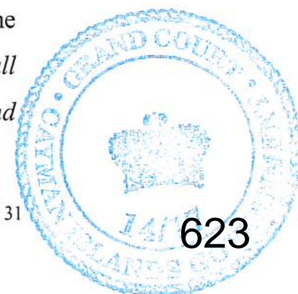
Has Top Jet established the right to bring a derivative action under Cayman law?

33. Mr. McKie submits that a derivative action may only be brought if it is shown that one of the four exceptions to the rule in *Foss v Harbottle* applies and that the fraud on the minority exception applies in the present case, on the assumption that the facts and matters set out in the Petition are proven at trial. In particular he submits that:

(a). it is sufficient for these purposes that the shareholder bringing the claim (and the term "minority shareholder" in this context) includes a person who, like Top Jet in respect of Sino Jet, holds 50% of the issued share capital of the company concerned. He cites as authority for this proposition the judgment of Sir Mervyn Davies in *Barrett v Duckett* [1995] 1 BCLC 73, Ch D, at 79-80 (rev'd on other grounds [1995] 1 BCLC 243, CA) where he said that "*Mrs. Barrett is not, strictly speaking, a minority shareholder since she has 50 shares, as does Mr. Duckett* [being the only other shareholder]. *Nevertheless she is, in my view, a minority shareholder for the purposes of the exceptions to Foss v Harbottle*".

(b). it is necessary for the shareholder to establish conduct which constitutes a fraud on the minority. In the present case the failure by the Sino Jet directors appointed by Skyblueocean (acting as directed by Mr. Kraus and possibly his sister and for the benefit of Jet Midwest and Mr. Kraus and his sister) to authorise and cause Sino Jet to enforce its rights and commence proceedings against Jet Midwest is sufficient in the circumstances to satisfy this requirement.

(c). it is also necessary for the shareholder to establish that the wrongdoers are in control of the company. In the present case the wrongdoers are identified, it appears, as Mr. Kraus (and his sister). It is said that they have (negative) control of the Sino Jet board (since Mr. Kraus is a director and controls the other Sino Jet directors appointed by Skyblueocean) and of Sino Jet (since Mr. Kraus and his sister control Skyblueocean whose consent is required to the commencement of proceedings by Sino Jet against Jet Midwest). Mr. McKie noted that in *Prudential Assurance* the Court of Appeal recognised that the term control "... *embraces a broad spectrum extending from an overall absolute majority of votes at one end, to a majority of votes at the other end*



made up of those likely to be cast by the delinquent himself plus those voting with him as a result of influence or apathy"

(d). a claim by a company for breach of a contract made between the company and a third party may be brought derivatively (so that there is no basis in principle for denying Top Jet the right to bring Sino Jet's claim for breach of the Consignment Agreement derivatively against Jet Midwest).

(e). it was also unnecessary for the shareholder to show that it had made a demand or request to the company's board or other shareholders to commence the relevant proceedings where it could show that such a demand or request would be futile and would not be acted on, and this was such a case.

34. I accept that a fifty per cent shareholder may bring a derivative claim. The principle applies whenever a shareholder is not able to persuade or cause the normal organs of the company to commence proceedings in respect of a wrong done to it. The essential question is whether the company is being prevented from pursuing a claim which the company legitimately has (see Knox J in *Smith v Croft (No 2)*).

35. As regards the conduct which satisfies the fraud requirement Mr. McKie submitted that the term "fraud" is attributed a wide meaning which embraces both fraud in a strict sense and, short of fraud, a breach of duty which confers a benefit on the directors or third parties. He relied on the statements of the principle in:

(a). *Daniels v Daniels* [1978] Ch 406 at 413-414 (per Templeman J) as follows:

> "*The authorities which deal with simple fraud on the one hand and gross negligence on the other do not cover the situation which arises where, without fraud, the directors and majority shareholders are guilty of a breach of duty which they owe to the company, and that breach of duty not only harms the company but benefits the directors. In that case it seems to me that different considerations apply. If minority shareholders can sue if there is fraud, I see no reason why they cannot sue where the action of the majority and the directors, though without fraud, confers some benefit on those directors and majority shareholders themselves. It would seem to me quite monstrous - particularly as fraud is so hard to plead and difficult to prove - if the confines of the exception to Foss v. Harbottle ..., were drawn so narrowly that directors could make a profit out of their negligence. .... The principle which may be gleaned from Alexander v. Automatic Telephone Co. ... (directors benefiting themselves), from Cook v. Deeks ... (directors diverting business in their own favour) and from dicta in Pavlides v. Jensen ... (directors appropriating assets of the company) is that a minority shareholder who has no other remedy may sue where*

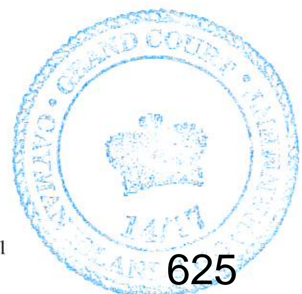
> *directors use their powers, intentionally or unintentionally, fraudulently or negligently, in a manner which benefits themselves at the expense of the company* [underlining added by me]."

(b). *Estmanco (Kilner House) Ltd v GLC* [1982] 1 WLR 2 at 12 (***Estmanco***) (per Megarry V-C) as follows:

> "*Apart from the benefit to themselves at the company's expense, the essence of the matter seems to be an abuse or misuse of power. "Fraud" in the phrase "fraud on a minority" seems to be being used as comprising not only fraud at common law but also fraud in the wider equitable sense of that term, as in the equitable concept of a fraud on a power.*
>
> *Now of course Daniels v. Daniels ... was a case on acts by directors as such, rather than by shareholders, and I do not forget this. At the same time it seems to me to be useful as preventing "fraud" from being read too narrowly. Suppose, too, the decision to sell the land had been made not by the husband and wife qua directors, but by a resolution of the company carried by their votes: could it then be said that the minority could not sue? Is this exception from the rule in Foss v. Harbottle open to easy evasion by directors who hold the majority of votes in general meeting if they take care to reach their decisions not by voting as directors but by voting as shareholders? I think not*" [underlining added by me].

36. Mr. McKie submitted that in the present case the conduct constituting the fraud was that of Mr. Kraus and the other Sino Jet directors appointed by Skyblueocean and that Top Jet had asserted in the Petition that there had been a breach of duty by these directors. He referred to and relied on the facts and matters set out in the Petition in particular paragraphs 66 and 67 ("*a majority in favour of bringing proceedings cannot be obtained because three of the six members of the board (Mr. Kraus, Mr. Woolley and Ms Lumley) have an interest in shielding Jet Midwest and therefore have a conflict of interest; have turned a blind eye to Jet Midwest's failure to perform its obligations under the Consignment Agreement and would block Sino Jet from enforcing the Consignment Agreement*") and paragraph 82 ("*Skyblueocean can prevent Sino Jet from enforcing its rights only by misusing its de facto control of Sino Jet and by causing the directors it has appointed and controls to breach their fiduciary duties to the Sino Jet shareholders as a whole for the benefit of Jet Midwest and at Sino Jet's expense.*")

37. Assuming these asserted facts to be true, and assuming that Sino Jet has or is likely to have a good claim against Jet Midwest, the Sino Jet directors appointed by Skyblueocean appear to be in breach of their fiduciary duty by failing to take action to protect the interests of Sino Jet and all its shareholders by enforcing its rights against Jet Midwest. They are improperly putting the interests of one of the



shareholders and of Mr. Kraus and his sister ahead of those of Sino Jet as a company and all its shareholders.

38. In such circumstances a claim could have been brought derivatively against Mr. Kraus and the other Sino Jet directors appointed by Skyblueocean. Such a claim could have been brought in this jurisdiction. It is not clear why this was not done. Instead, the derivative action has been brought against a third party that is neither a director nor a shareholder. Mr. McKie accepted that there are difficulties with and limitations on derivative claims against third parties. He cited passages from the report prepared by the Law Commission of England & Wales entitled *Shareholders Remedies* (published on 24 October 1997) in connection with the proposed reform of the law relating to derivative actions which discussed these limitations both in the context of the reforms proposed by the Law Commission and the old common law. The following passages are of particular relevance:

> "*6.27 The second concern raised by respondents was that there may be some situations where it should be possible to bring a derivative action which would fall outside the new procedure. <u>This may be because there is no breach of duty by directors (even on the widest possible meaning of "duty"), or it may be because the cause of action does not arise out of the breach of duty ...</u>*
>
> *6.31 So far as the second situation is concerned, one respondent gave the following example. <u>A profitable company is a victim of a tort by a third party, and the board, although otherwise committed to the well-being of the company, have ulterior motives of their own for not wishing to enforce the remedy for the tort. Although the board would in those circumstances be in breach of duty, their breach would not have given rise to the claim</u>.*
>
> *6.32 <u>We accept that in this type of situation an individual shareholder would have no right to bring a derivative action against the third party tortfeasor under our proposals. (There would of course be a potential claim for damages against the directors themselves, although this may give rise to difficulties of causation or quantification, and it is possible that the directors may not have sufficient funds to meet the claim). However, we do not consider that this is an issue which needs to be addressed for two main reasons.</u>*
>
> *6.33 <u>First, we are not aware of any cases under the current law where a derivative action has been successfully brought in circumstances such as those described in paragraph 6.31</u>...*
>
> *6.34 Secondly, (and more importantly) it is consistent with the proper plaintiff principle which we endorsed in the consultation paper and which received virtually unanimous support on consultation. <u>The decision on whether to sue a third party (i.e. someone who is not a director and where the claim is not closely connected with a breach of duty by a director) is clearly one for the board. If the directors breach their duty in deciding not to pursue the claim then (subject to the leave of the court) a derivative claim can be brought against them. To allow shareholders to have involvement in whether claims should be brought against third parties in our view goes too</u>*

> *far in encouraging excessive shareholder interference with management decisions. This is particularly important as we are proposing that derivative actions are to be available in respect of breaches of directors' duties of skill and care. A line has to be drawn somewhere and we consider that this is both a logical and clearly identifiable place in which to draw the line.*
>
> *6.35 There may be situations where the line is not quite so easy to draw. For example, a company may have a claim in negligence against an auditor who fails to spot that the directors have misappropriated corporate assets. The factual background to the claim against the auditor is the breach of duty by the directors, but the auditor has neither participated in the fraud nor received corporate assets. Our view is that it is not appropriate for a derivative action to be brought against the auditor in these circumstances, and we do not consider that it would be possible to bring such an action under the terms of our draft bill. The cause of action against the auditor does not arise as a result of the directors' act, but rather their act is merely the setting against which the auditor's (separate) default operates.*
>
> *6.36 We therefore consider that the new procedure should only be available for claims in respect of breaches of duty by a director (including claims against third parties as a result of such breaches), and that for these purposes director should include a shadow director.*" [underlining added by me]

39. It seems to me right that where a third party has a liability to the company (whether in contract or tort) but the third party has neither participated in the conduct constituting the fraud on the minority nor received corporate assets then it would not be possible for a claim against them to be brought derivatively. The fraud whose existence justifies the derivative action (and an exception being made to the principle that only the company can bring a claim for wrongs done to it) must give rise to the third party's liability. The third party must be a party or accessory to or closely associated with the conduct which gives rise to the fraud on the minority. If there were no, or an insufficiently close, relationship between Jet Midwest and Mr. Kraus (and the Sino Jet directors appointed by Skyblueocean), such that Jet Midwest could be treated as an independent third party, it is likely that the claim for breach of contract or for an account of sums owed in relation to the sale of Sino Jet's equipment could not be brought derivatively (since Jet Midwest's breach of the Consignment Agreement would be independent of the wrongful conduct which justifies and permits Top Jet as a minority shareholder, rather than the company's board, having control of litigation to enforce the company's rights). But Mr. McKie submits that this difficulty does not arise here because Top Jet's case is based on its assertion that Jet Midwest is to be treated as controlled by Kraus (and his sister), the wrongdoers. Jet Midwest is therefore to be treated as an insider and either as having participated in the conduct constituting the fraud on the minority or as being so closely connected with the wrongdoers as to justify the claim for breach of the Consignment Agreement being

subject to a derivative claim (Jet Midwest might also be said to have received Sino Jet's assets in so far as it has an obligation to account for proceeds of sale that belong to Sino Jet).

40. The Petition avers and asserts, by reference to certain specified documents, the following:

(a). that Skyblueocean owns fifty per cent of the shares in Sino Jet and has appointed and controls the three Sino Jet directors it has appointed (paragraph 33).

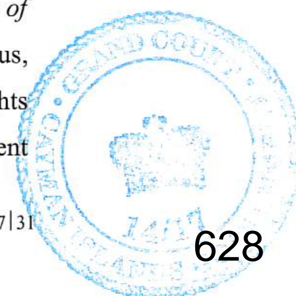
(b). that Mr. Kraus is the sole director of Skyblueocean (paragraph 36) and one of the two members of Skyblueocean (paragraph 37). The other member is Jet Midwest Group, LLC (***JMG***).

(c). that Mr. Kraus is the founder and Mr. Kraus and his sister are the two members of JMG (paragraphs 41 and 42). Mr. Kraus is also the CEO of JMG (paragraph 43).

(d). that the three directors of Jet Midwest are Mr. Kraus, his sister Karen Kraus and their brother Patrick Kraus Jet Midwest was founded by Mr. Kraus who manages its affairs (paragraph 50 and 51).

(e). that Jet Midwest was administratively dissolved when it entered into the Consignment Agreement and that under Missouri law when a company is administratively dissolved any director who conducts any business except that appropriate to wind up and liquidate its business and affairs is personally liable for any obligation incurred (paragraphs 48 and 49).

41. Accordingly, Mr. McKie submits that, assuming these facts are proved at trial, Top Jet will and does satisfy the test set out by Templeman J in *Daniels v Daniels* (as set out above) namely that it "*is ... a minority shareholder who has no other remedy* [and it] *may sue where directors use their powers, intentionally or unintentionally, fraudulently or negligently, in a manner which benefits themselves at the expense of the company*." The Sino Jet directors appointed by Skyblueocean, including Kraus, are abusing their position by failing to take steps to cause Sino Jet to enforce its rights against Jet Midwest, to the detriment of Sino Jet (and Top Jet as its only independent



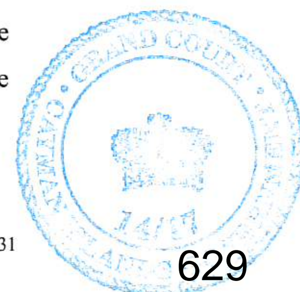
shareholder). Their failure to act or to consent to the action against Jet Midwest involves a breach of duty and an use or reliance on their powers as directors within the principle summarized above. Mr. Kraus has so acted in order to benefit himself and his sister. The other two Sino Jet directors appointed by Skyblueocean are acting on the instructions of and so as to benefit Mr. Kraus (and his sister). The benefit to Jet Midwest, of being relieved of or not being required to discharge its liabilities, is to be treated as a benefit received by Mr. Kraus (and his sister) for these purposes because Mr. Kraus either alone or with his close relatives controls and has a substantial financial interest in Jet Midwest.

42. Furthermore, Mr. McKie submits that because of the identity of financial interests among, and the common control exercised by Mr. Kraus and his sister over, Skyblueocean, Jet Midwest and the three Sino Jet directors appointed by Skyblueocean, Top Jet has satisfied the requirement that the wrongdoers must be in control of the company. The board of Sino Jet is in effect under the (negative) control of Mr. Kraus and his sister and they are the beneficiaries of the financial benefits that flow to Jet Midwest by being let off the hook from its liabilities under the Consignment Agreement.

43. In support of his argument that Top Jet does not need to show that a formal request or demand has been made to the Sino Jet board or Skyblueocean to consent to the action against Jet Midwest Mr. McKie relies on the judgment of Jessel MR. in *Russell v Wakefield Waterworks Co* (1875) LR 20 Eq 474 at 482 as follows:

> *"It is not necessary that the corporation should absolutely refuse by vote at the general meeting, if it can be shewn either that the wrong-doer had command of the majority of the votes, so that it would be absurd to call the meeting; or if it can be shown that there has been a general meeting substantially approving of what has been done; or if it can be shewn from the acts of the corporation as a corporation, distinguished from the mere acts of the directors of it, that they have approved of what has been done, and have allowed a long time to elapse without interfering, so that they do not intend and are not willing to sue. In all those cases the same doctrine applies, and the individual corporator may maintain the suit."*

44. I am prepared to accept, for the purposes of this application, that based on the facts and matters in the Petition (and on the assumption that the facts stated and averred are proved at trial) Top Jet has a right under Cayman law to bring and continue the Missouri Proceedings derivatively on behalf of Sino Jet. The Petition alleges:



(a). that Mr. Kraus (and his sister) control Skyblueocean, Jet Midwest and the other two Sino Jet directors appointed by Skyblueocean.

(b). a breach of duty by the Sino Jet directors appointed by Skyblueocean including Mr. Kraus by turning a blind eye to Jet Midwest's failure to perform its obligations under the Consignment Agreement and acting, or failing to act, with a view to promoting the interests of Mr. Kraus (and his sister) rather than those of Sino Jet.

(c). that by reason of the control of Skyblueocean and the Sino Jet directors appointed by Skyblueocean Mr. Kraus (and his sister) can prevent Sino Jet taking action to enforce Jet Midwest's obligations.

(d). that Mr. Kraus (and his sister) are aware of Sino Jet's claims against Jet Midwest and because of the control they exercise over Skyblueocean and the other Sino Jet directors appointed by Skyblueocean any request or demand to consent to the action against Jet Midwest would be refused (and that Mr. Kraus and the other Sino Jet directors appointed by Skyblueocean, and Skyblueocean, have had ample opportunity to give such consent).

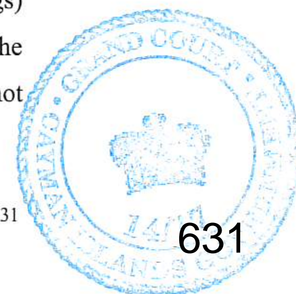
(e). that Jet Midwest, being controlled by Mr. Kraus (and his sister) is closely connected with those whose conduct justifies Top Jet being permitted to bring a derivative claim and such that the benefits obtained by Jet Midwest in not having to discharge its obligations to Sino Jet can be treated as benefits received by Mr. Kraus (and his sister).

45. Based on the facts and matters asserted in the Petition this seems to me to be a case that falls within the principle establishing and policy behind the exceptions to the rule in *Foss v Harbottle*. If Top Jet was not permitted to bring the Missouri Proceedings derivatively Sino Jet would be unable to recover what is owed to it by Jet Midwest because of the control exercised and abuse of power by Mr. Kraus (and his sister) and thereby a wrong done to Sino Jet would go unremedied. In deciding whether to allow a shareholder to bring a derivative action on behalf of a company, the court must determine whether the shareholder is bringing the action in good faith for the benefit of the company for a wrong done to the company for which no other remedy is available. This test seems to me to be satisfied in the present case based on the matters relied on and averred in the Petition.

46. Therefore Top Jet is entitled to and I am prepared to make a declaration that if the facts and matters set out in the Petition are proven at trial then Top Jet is entitled under Cayman law to bring the Missouri Proceedings against Jet Midwest derivatively on Sino Jet's behalf. It seems to me that a single declaration in these terms is preferable to the two declarations sought in paragraphs 1A (a) and (b) of the Re-amended Originating Summons.

47. I have considered whether it is right to make these declarations in the form sought at this stage in the Missouri Proceedings and without sight of all of the evidence to be filed in the Missouri Proceedings and without taking into account the evidence to be filed by Jet Midwest. I do consider that making a declaration based only on the outline facts pleaded in the Petition and without having the chance to consider the evidence in support of and opposition to the Petition is not entirely satisfactory. But in the absence of an application by Jet Midwest requesting that I defer a decision until such evidence is available and filed in these proceedings or seeking to oppose the relief sought by Top Jet I am prepared nonetheless to make the declaration in the form I have set out above. Top Jet must accept of course that it may well be argued that a declaration made in these circumstances is of limited use and effect (what happens if only some of the facts and matters relied on are proved and established in the Missouri Proceedings, for example?). Furthermore, it may be open to Jet Midwest (or others) to make a further application subsequently once all the evidence is available inviting the Court to revisit the position based on further and fuller evidence. I do not express a view on whether such a further application would be possible or permitted (and am not encouraging one) but it seems to me to be right to mention the possibility (Lightman J in his judgment in *Fraser v Oystertec plc*, above, does suggest, in the different context of the position in English law at the relevant time, that the court exercises continuing supervision over derivative claims and at least in the case of leave to continue derivative actions the court's view may need to be reviewed at different stages of the action).

48. As regards the declaration sought in paragraph 1A(c) of the Re-amended Originating Summons (that if, as a matter of Missouri law, Cayman Islands law governs the question, Top Jet had standing to commence and to continue the Missouri Proceedings) I consider that it undesirable to make a declaration which depends on and refers to the position under Missouri law before that position is established. Accordingly I shall not make the declaration set out in that paragraph.



The indemnity costs issue

49. In paragraph 2 of the Re-amended Originating Summons Top Jet sought an order pursuant to GCR O.15, r.12A(2), that it be indemnified out of Sino Jet's assets in respect of its costs incurred and to be incurred in the Missouri Proceedings and these proceedings. In paragraph 2A(c) of the Re-amended Originating Summons Top Jet sought in the alternative an order that if appointed as a representative of Sino Jet pursuant to GCR O.15, r.12(1) it be indemnified out of Sino Jet's assets in respect of its costs incurred and to be incurred in the Missouri Proceedings and these proceedings. Top Jet did not however in paragraph 1A of the Re-amended Originating Summons deal with or seek a declaration or other order requiring Sino Jet to indemnify it in respect of such costs.

50. In his written submissions for the hearing of the Re-amended Originating Summons on 8 December Mr. McKie stated that Top Jet proposed that that issues of costs be addressed following the Court's determination of whether to grant the declarations sought regarding derivative standing. As a result Mr. McKie made no submissions on the costs issue in his written submissions or in his oral submissions at that hearing. In the circumstances I propose to say nothing further regarding costs and to invite Mr. McKie to notify the Court and the other parties of what further orders, if any, he seeks and to provide written submissions explaining what is sought and the basis for such further relief.

THE HON. JUSTICE SEGAL
JUDGE OF THE GRAND COURT
CAYMAN ISLANDS