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[2007–09 Gib LR 20]

SAVANNAH CONSULTING LIMITED and MITCHELL v. MINTLEY INVESTMENTS LIMITED and FIVE OTHERS

SUPREME COURT (Schofield, C.J.): January 25th, 2007

Companies—legal proceedings—action in respect of corporate wrong—rule in Foss v. Harbottle—minority shareholders may bring derivative action as exception to rule if breach of fiduciary duties by other shareholders (aided by collaborators with voting rights) causes loss to company—proof of clear breach of self-dealing rule sufficient on its own to justify derivative action

The claimants brought an action alleging breach of fiduciary duty by the defendants.

Mintley Investments Ltd. was a Gibraltar company involved in oil and gas exploration. Its entire share capital was owned by Parliament Lane Management Ltd. ("PLM"), as a nominee for two companies—Savannah Consulting Ltd. (owned and controlled by Peter Mitchell), which itself held half its share capital for Peter Mitchell and half for David Jamison, and Cabana Services Ltd., a Gibraltar company represented by Robert Sheard—and the SJR Rodger Children's Trust ("the Trust"), which held its shares for Stephen Rodger and/or the beneficiaries of the Trust. Peter Mitchell and David Jamison were each equitable owners of 23% of the shares, and Cabana and the Trust were each equitable owners of 27%. In 2004, Mintley bought 1.5m. shares in Valkyries Petroleum Corporation ("VPC"), borrowing $3.5m. from the Trust to enable it to do so, half of which was underwritten by Peter Mitchell. In April 2005, it was agreed at a meeting of Mintley's board of directors (at which Savannah, the minority shareholder, was not present) that the loan would be repaid to the Trust by transferring to it the 1.5m. shares. The value of the shares increased by more than 450% in the year after being transferred to the Trust. The claimants, as minority shareholders, brought the present derivative proceedings on behalf of Mintley, alleging breaches of fiduciary duty by Mintley, PLM, PLN, Rodger, Sheard and Cabana, and sought disclosure orders, which were granted in July 2006. The defendants sought to prevent the claimants from continuing with their derivative action; both parties also applied for summary judgment.

The claimants submitted that (a) they should be allowed to pursue the claim as a derivative action on behalf of Mintley, as the board was under the control of those who had breached their fiduciary duty to the company, and the situation therefore fell under an exception to the rule in *Foss* v.

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Harbottle; (b) the defendants had breached the self-dealing rule, the fair dealing rule, the duty to avoid conflicts of interest and the no-profit rule, in that they had preferred the interests of the Trust to those of the company, and that it was not necessary to show anything beyond this to proceed with a derivative claim; (c) the breaches of fiduciary duty by the defendants had in any case been conscious and deliberate; (d) even if Robert Sheard had not derived benefit from the transfer of the shares, he had worked closely with Stephen Rodger, who had derived a benefit from the transfer, and was therefore a party to the transaction, bringing it within the exception to the rule in *Foss* v. *Harbottle*; (e) an action being heard in London had arisen out of events that took place after the present action had commenced, and the inconsistency in evidence was due to the representations of the defendants; (f) the court should have regard to the equitable ownership of the shares, from which it was clear that the claimants neither knew nor approved of the transfer; (g) neither the fact that other shareholders were opposed to the action nor its cost excused the defendants' breaches of fiduciary duty; and (h) the defence stood no real prospect of success, and summary judgment should therefore be granted.

The defendants submitted in reply that (a) the claimants should not be allowed to pursue the claim as a derivative action on behalf of Mintley, as the company was not in the control of the wrongdoers, and proceedings brought by the company itself would not therefore be stifled, and the situation did not fall under one of the exceptions to the rule in *Foss* v. *Harbottle*; (b) while there had been a breach of the self-dealing rule, it was for the defendants to show more than a "mere breach"; (c) there was no evidence to support the allegation that the breaches of fiduciary duty had been conscious and deliberate, or that the transfer of the VPC shares had been at an undervalue; (d) a breach of the self-dealing rule could be ratified by a majority of the shareholders (including the alleged wrongdoers) and the breach had been so ratified; (e) Robert Sheard had not benefited from the impugned transaction, and since Stephen Rodger held only 27% of the shares, he could not be said to be stifling proceedings, with the result that a derivative action was not available; (f) Robert Sheard and Stephen Rodger were being distracted from the management of the company (to which both were crucial) by the litigation; (g) the claimants' interest in pursuing the claim was personal to Mitchell, and not on the behalf of the company, as was shown by different evidence given by the claimants in proceedings in London; (h) the claimants had chosen to hold the shares beneficially, rather than as registered shareholders, and so could not claim the benefits of being a registered shareholder, such as voting at shareholders' meetings; (i) the other shareholders in the company opposed the action, which had already cost the company nearly £500,000, and no independent board would risk the cost of litigation; and (j) the claimants' action stood no real prospect of success, so summary judgment should be granted.

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Held, allowing the claimants to proceed with the derivative action and refusing both applications for summary judgment:

(1) The claimants would be allowed to proceed with the derivative action on behalf of Mintley. Although only 27% of the shares were held by Stephen Rodger—with the result that the company was not *prima facie* in the control of the wrongdoers, and the exception to the rule that the action should be brought by the company, rather than by shareholders stated in *Foss* v. *Harbottle* did not *prima facie* apply—it was clear that Robert Sheard worked closely with Stephen Rodger in relation to the company, and had been a party to the transfer of the shares. Rodger and Sheard had together caused a loss to the company by breaching the fiduciary duty that they owed it, and even though only Rodger could at this stage be shown to have derived a direct benefit from the transaction, it would be wrong to allow Sheard to use his voting rights to condone the transaction to which he himself was party (para. 23; paras. 35–36).

(2) The claimants did not need to show any breach of duty from which the defendants profited in a personal capacity beyond a breach of the self-dealing rule to be able to proceed with the derivative action, although such a breach did have to be clear. The fact that there were also allegations of other breaches of fiduciary duty, including the selling of core assets of the company without authority, was also to be borne in mind by the court in deciding whether to allow the derivative action to proceed (para. 18; paras. 20–21).

(3) The question of costs would not be decisive in the exercise of the court's discretion to allow the application to proceed; it would be determined at the end of the case. Similarly, the fact that Rodger and Sheard might be distracted from the running of the company was not decisive for the application, and, given the allegations of breach of fiduciary duty that had been made and *prima facie* proved, neither was the opposition of David Jamison, another minority shareholder, to the continuation of the proceedings. The fact that the claimants may have changed their positioning was also not relevant, as it was to be expected that parties' arguments would change in a case such as the present in which disclosure was still ongoing (paras. 30–33).

(4) The beneficial ownership of the shares was important in determining whether the claimants knew about the disputed transaction; it was clear that they neither knew nor approved of it. The court, in deciding the application, was concerned with the application of equitable principles, and should have regard to the equitable ownership of the shares. This principle was all the more compelling given that PLM held the shares subject to a declaration of trust directing it to exercise its voting rights in accordance with the wishes of the beneficial owners of the shares. While it was true that the claimants had chosen not to be registered as owners of the shares, retaining only beneficial ownership, this did not grant licence to those in control of the company to breach their fiduciary duty (paras. 28–29; para. 37).

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(5) Summary judgment would not be granted to either party. There were substantial issues to be raised at the trial on both sides, and it could not be said that either the claimants' or the defendants' claims stood no real prospect of success (paras. 38–40).

Cases cited:

(1) *Bamford* v. *Bamford*, [1970] Ch. 212; [1969] 2 W.L.R. 1107; [1969] 1 All E.R. 969, *dicta* of Harman, L.J. distinguished.
(2) *Burland* v. *Earle*, [1902] A.C. 83; (1901), 71 L.J.P.C. 1; 50 W.R. 241; 85 L.T. 553; 18 T.L.R. 41; [1900–3] All E.R. Rep. Ext. 1452, observations of Lord Davey considered.
(3) *Cook* v. *Deeks*, [1916] 1 A.C. 554; (1916), L.J.P.C. 161; [1916–17] All E.R. Rep. 285, *dictum* of Lord Buckmaster, L.C. applied
(4) *Daniels* v. *Daniels*, [1978] Ch. 406; [1978] 2 W.L.R. 73; [1978] 2 All E.R. 89, *dicta* of Templeman, J. applied.
(5) *Deakin* v. *Faulding*, [2001] 35 L.S. Gaz. R. 32; [2001] All E.R. (D.) 465 (Jul.), applied.
(6) *Domoney* v. *Godinho*, [2004] 2 BCLC 15; [2004] EWHC 328 (Ch), *dicta* of Hart, J. applied.
(7) *Duomatic*, *In re*, [1969] 2 Ch. 365; [1969] 2 W.L.R. 114; [1969] 1 All E.R. 161, not followed.
(8) *Foss* v. *Harbottle* (1843), 2 Hare 461; 67 E.R. 189, distinguished.
(9) *North-West Transp. Co.* v. *Beatty* (1887), 12 App. Cas. 589; 56 L.J.P.C. 102; 3 T.L.R. 789, distinguished.
(10) *Prudential Assur.* v. *Newman Indus. (No. 2)*, [1982] Ch. 204; [1982] 2 W.L.R. 31; [1982] 1 All E.R. 354, applied.

F. Tregear, *Q.C.* and *D. Bossino* for the claimants;
A.A. Vasquez, *Q.C.* and *R.A. Triay* for the first, second and third defendants;
R. Hollington, *Q.C.* and *T. Leech* for the fourth, fifth and sixth defendants.

1 **SCHOFIELD, C.J.:** Mintley Investments Ltd., the first defendant, was incorporated in Gibraltar on July 9th, 2001. Mintley commenced trading as a consultant in relation to oil and gas exploration, and now also carries on oil and gas exploration in its own right. At all material times Parliament Lane Management Ltd. ("PLM"), the second defendant, held the entire issued share capital of Mintley as a nominee or bare trustee. In 2005 PLM held the shares in the following proportions for—

(a) Savannah Consulting Ltd., the first claimant, a company registered in Antigua wholly owned and controlled by Peter Ronald Mitchell ("Mitchell"), the second claimant, for and on behalf of Mitchell: 23%;

(b) Savannah, for and on behalf of David Jamison ("Jamison"): 23%;

(c) Cabana Services Ltd., the fifth defendant, a company registered in

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Gibraltar, represented by Robert Sheard ("Sheard"), the fourth defendant: 27%; and

(d) the SJR Rodger Children's Trust ("the Trust"), for and on behalf of Stephen Rodger ("Rodger"), the sixth defendant, and/or the beneficiaries of the Trust: 27%.

Since March 2006, Jamison's 23% interest in Mintley has been held by a company called Gipsymoth Ltd.

2 PLM, as well as being a director of Mintley and holding Mintley's shares, is also a trustee of the Trust. Parliament Lane Nominees Ltd. ("PLN"), the third defendant, is a director of Mintley. Parliament Corporate Services Ltd. ("PCS") acts as secretary to Mintley. It is the claimants' case that Rodger and Sheard are shadow directors of Mintley in that PLN and PLM are accustomed to act in accordance with their instructions.

3 Mintley was, in 2004, pursuing various business opportunities and, amongst other things, it acquired 1,500,000 shares in a Canadian company called Valkyries Petroleum Corporation ("VPC"). It is the claimants' case that the VPC shares were intended to be held as core assets of Mintley's business, although I think it right to say that there seems to be dispute on that point.

4 In order to finance these business opportunities, Mintley borrowed $3.5m. from the Trust (which transaction I shall refer to as "the loan"). The loan was repayable within 180 days, and the Trust was to have a first charge over the assets of Mintley until repayment in full. The Trust was also to receive a share of the various business opportunities, including a number of shares in VPC. Mitchell agreed with Mintley, the Trust and Rodger that he would underwrite—in the sense of securing repayment by Mintley to the Trust—50% of the amount drawn down by it as and when required. Under that agreement Mitchell paid $389,110 at the behest of Rodger in respect of 50% of losses sustained by Mintley in exploration costs of oil wells which were dry, which costs had been funded by part of the loan.

5 On April 12th, 2005, a meeting of Mintley's board of directors took place in Gibraltar. It was attended by PLM, PLN and PCS, and also by Rodger and Sheard. In that meeting it was agreed that the total outstanding on the loan would be repaid by transfer to the trustee of the Trust of the 1,500,000 VPC shares. This decision was made without reference to the minority shareholder, Savannah, which held 23% of Mintley's shares each for Mitchell and Jamison.

6 This decision is the subject of this suit. In the event, between April 2005 and April 2006 the VPC shares increased in value from $3.15 to $14.30 each, which increased the value of the shares formerly held by Mintley from $4,725,000 to $21,450,000. It is the claimants' case that the

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transfer of the VPC shares was made in breach of fiduciary duty. It, they say, involved a breach of (a) the self-dealing rule; (b) the fair dealing rule; (c) the duty to avoid conflict of duty with interest; and (d) the no-profit rule.

7 The claimants seek permission to pursue this action as a derivative action on behalf of Mintley. There were, in addition to that application, applications by all parties for summary judgment together with an application by the claimants, under the Civil Procedure Rules, r.25.6, for interim relief pending a hearing as to quantum, and, by the fourth, fifth and sixth defendants, for security for costs. In the event I heard argument on the claimants' application to pursue the action as a derivative claim only.

8 The matter first came before me on the claimants' application for injunctive relief against Mintley, PLM, PLN, Rodger, Sheard and Cabana, which was accompanied by applications for disclosure. I made the orders sought, *ex parte*, on July 6th, 2006. On the return date the defendants applied to set aside those orders. It being conceded by the defendants that there was a serious issue to be tried on the issue of self-dealing, the issues I was called upon to determine were whether I had been materially misled in the claimants' original application and whether the injunctions were necessary to secure the claimants' position. On August 9th, 2006, I decided the application in the claimants' favour. There is, I understand, an appeal pending in relation to that decision. There followed an application by the claimants, heard on October 10th, 2006, seeking to restrain the holding of an Extraordinary General Meeting of Mintley on issues that do not concern me in these applications. At that hearing I relaxed certain terms of the injunction on the defendants' application.

9 The main issue that I am called upon to determine in this application is whether the claimants should have permission to continue with their derivative claim. It is common ground between the parties that the claimants must satisfy me that they have a *prima facie* case with a prospect of success. It is also common ground that the claimants have to establish to the required standard that the action falls within one of the exceptions to the rule in *Foss* v. *Harbottle* (8).

10 The rule in *Foss* v. *Harbottle* is that where a wrong has been done to a company it is only the company which can sue in respect of that wrong. One exception to this rule is that a derivative action may be brought where a fraud has been practised on a company and the board of the company is under the control of the fraudsters, which would cause the action to be stifled. The defendants acknowledge, for the purposes of this hearing, that there has been a breach of fiduciary duty, in that there has been a breach of the self-dealing rule. However, they contend that it is for the claimants to show a breach of duty distinct from what they describe as "a mere breach"

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of the self-dealing rule. Furthermore, they contend that the wrongdoers are not in control of the company so as to stifle any proceedings.

11 The defendants referred me to the English Court of Appeal in *Prudential Assur.* v. *Newman Indus. (No. 2)* (10), in which the court (Cumming-Bruce, Brightman and Templeman, L.JJ.) said ([1982] Ch. at 210–211) that—

> "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."

12 The defendants say that the claimants' pleaded case is that PLM and PLN (as directors of Mintley) and Rodger and Sheard (as shadow directors) acted in breach of their fiduciary duty to act in the best interests of Mintley, and preferred the interests of the Trust to that of Mintley. The allegations are that the breaches were conscious and deliberate, which is tantamount to an allegation of fraud, on which the claimants would face a very high evidential burden. The defendants submit that there is no evidence to support such allegations and, indeed, the claimants have now diluted their allegation to one of mere conflict of interest and duty, and have conceded that there are no allegations of dishonesty made against Cabana and Rodger. No such allegation is pleaded against Sheard. The defendants submit that it is well established that breach of the strict self-dealing rule does not on its own fall within the exception at para. (5)

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of the above passage from *Prudential Assur.* and that it is *prima facie* a wrong which can be ratified by a majority of the shareholders including the alleged wrongdoer. Furthermore, that the impugned transaction in this case was and would be approved by a majority of the shareholders without the Trust's interest in shares being voted within the principle stated in para. (2) of the above passage.

13 I have been referred to the decision of the Privy Council in *North-West Transp. Co.* v. *Beatty* (9). In that case a director and majority shareholder sold a steamer to the company. The transaction was approved in general meeting by reason of the votes cast by that director/shareholder. It was held that the director/shareholder was entitled to exercise his voting power as a shareholder to ratify the contract. However, it should be emphasized that it was proved that the acquisition of the steamer was essential for the conduct of the company's business, that the particular steamer was well adapted for the purpose and that it was not within the power of the company to acquire any other steamer equally well adapted and, furthermore, that the price agreed was not excessive or unreasonable.

14 In *Bamford* v. *Bamford* (1), all but 500,000 shares in a public company had been issued. The power to allot the unissued shares was vested in the directors of the company, which they did, not for the company's benefit, but with a view to blocking a take-over bid. Harman, L.J. had this to say ([1970] Ch. at 237–238):

> "It is trite law, I had thought, that if directors do acts, as they do every day, especially in private companies, which, perhaps because there is no quorum, or because their appointment was defective, or because sometimes there are no directors properly appointed at all, or because they are actuated by improper motives, they go on doing for years, carrying on the business of the company in the way in which, if properly constituted, they should carry it on, and then they find that everything has been so to speak wrongly done because it was not done by a proper board, such directors can, by making a full and frank disclosure and calling together the general body of the shareholders, obtain absolution and forgiveness of their sins; and provided the acts are not ultra vires the company as a whole everything will go on as if it had been done all right from the beginning. I cannot believe that that is not a commonplace of company law. It is done every day. Of course, if the majority of the general meeting will not forgive and approve, the directors must pay for it.
>
> It will be remembered that in the well-known case of *Regal (Hastings) Ltd.* v. *Gulliver* [1967] 2 A.C. 134 Lord Russell of Killowen in the course of his speech made a very significant observation about this. In that case certain directors had acquired some shares by

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> reason of the fact that they were directors of a certain company. They afterwards sold those shares at a profit. It was held that they must account for the profit because it had been obtained as a result of their directorships and therefore was in the nature of trust property of the company. Lord Russell said, at p. 150:
>
> > 'The suggestion that the directors were applying simply as members of the public is a travesty of the facts. They could, had they wished, have protected themselves by a resolution (either antecedent or subsequent) of the Regal shareholders in general meeting. In default of such approval, the liability to account must remain.'
>
> So . . . the noble Lord considered it obvious that they could, by obtaining either a previous approval or a subsequent ratification, retain the profit, which otherwise they must disgorge.
>
> So it seems to me here that these directors, on the assumptions which we have to make, made this allotment in breach of their duty—mala fide, as it is said. They made it with an eye primarily on the exigencies of the take-over war and not with a single eye to the benefit of the company, and, therefore, it is a bad allotment. But it *is* an allotment. There is no doubt that the directors had power to allot these shares. There is no doubt that they did allot them. There is no doubt that the allottees are on the register and are for all purposes members of the company. The only question is whether the allotment, having been made, as one must assume, in bad faith, is voidable and can be avoided at the instance of the company—at their instance only and of no one else, because the wrong, if wrong it be, is a wrong done to the company. If that be right, the company, which had the right to recall the allotment, has also the right to approve of it and forgive it; and I see no difficulty at all in supposing that the ratification by the decision of December 15 in the general meeting of the company was a perfectly good 'whitewash' of that which up to that time was a voidable transaction. And that is the end of the matter."

That case, however, did not involve the exceptions to the rule in *Foss* v. *Harbottle* (8) (see the judgment of Russell, L.J. (*ibid.*, at 242)). Furthermore, there was no suggestion that the directors derived a profit from the impugned activity.

15 In *Burland* v. *Earle* (2), a director of a company purchased property without mandate from the company and under circumstances which did not make him a trustee thereof for the company. Thereafter he resold the property to the company at a profit. The Privy Council held that whether or not the company was entitled to rescission of the contract of resale, it was not entitled to affirm the contract and at the same time treat the

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director as trustee of the profit made. In delivering the opinion, Lord Davey had this to say ([1902] A.C. at 93–94):

> "It is an elementary principle of the law relating to joint stock companies that the Court will not interfere with the internal 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 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 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, is [a] 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 that 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. 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 *Menier* v. *Hooper's Telegraph Works.* 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.*"

16 Mr. Hollington submitted that fraud is no longer alleged by the claimants and that, in any event, there is simply no evidence that the impugned transaction was of a fraudulent or colourable nature. Nor is there any evidence that the transfer of the VPC shares was at an undervalue. Mr. Tregear, for the claimants, submits, on the other hand, that they do not have to show fraud in the sense of deceit, and that the breaches of fiduciary duty which are alleged, and demonstrated by the evidence, amount to fraud for the purposes of bringing this derivative action. He submits that there has been a breach of various rules of equity such as the

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"no conflict" rule, the "fair dealing" rule and the "no-profit" rule, as well as the rule against self-dealing.

17 Mr. Tregear has referred me to the Privy Council case of *Cook* v. *Deeks* (3) in which three directors of a company carrying on the business of railway construction contractors obtained a contract in their own names to the exclusion of the company. The contract was obtained under circumstances which amounted to a breach of trust by the directors and constituted them trustees of its benefits on behalf of the company. The three directors held three-quarters of the issued shares in the company and passed a resolution at a general meeting declaring that the company had no interest in the contract. It was held that the benefit of the contract belonged in equity to the company and the directors could not validly use their voting powers to vest it in themselves. Lord Buckmaster, L.C., in delivering the opinion of the Board, had this to say ([1916] 1 A.C. at 563):

> "Their Lordships think that, in the circumstances, the defendants T. R. Hinds and G. S. and G. M. Deeks were guilty of a distinct breach of duty in the course they took to secure the contract, and that they cannot retain the benefit of such contract for themselves, but must be regarded as holding it on behalf of the company."

18 Mr. Hollington submits that this supports his contention that there must be shown more than a breach of the self-dealing rule. As I understand his argument he submits that the word "distinct" in this passage means "distinct from a mere breach of the self-dealing rule." However, my understanding of the word "distinct" in that passage means that the defendants had been guilty of a "clear" or "obvious" breach of duty.

19 In *Daniels* v. *Daniels* (4) the plaintiffs were the minority shareholders of a company. They claimed that two directors who were the majority shareholders sold the company's land to one of the directors, who was the wife of the other, at an undervalue. It was held that the exception to the rule in *Foss* v. *Harbottle* (8) should include cases where, although there was no fraud alleged, there was a breach of duty by directors and majority shareholders to the detriment of the company and the benefit of the directors. Templeman, J., as he then was, had this to say ([1978] Ch. at 413–414):

> "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,

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> 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*, 2 Hare 461, were drawn so narrowly that directors could make a profit out of their negligence. Lord Hatherley, L.C. in *Turquand* v. *Marshall*, L.R. 4 Ch. App. 376, 386, opined that shareholders must put up with foolish or unwise directors. Danckwerts, J. in *Pavlides* v. *Jensen* [1956] 1 Ch. 565 accepted that the forbearance of shareholders extends to directors who are 'an amiable set of lunatics.' Examples, ancient and modern, abound. To put up with foolish directors is one thing; to put up with directors who are so foolish that they make a profit of £115,000 odd at the expense of the company is something entirely different."

20 Mr. Hollington argues that in *Daniels*, as in *Cook* v. *Deeks* (3), the court found that there had been actual wrongdoing in that there had been a failure to act in good faith in the interests of the company, which is absent from the allegations made in the present case. However, in my judgment, this case falls closer to *Daniels* and *Cook* v. *Deeks* than it does to *Prudential Assur.* (10), at least for the purposes of this application to pursue a derivative claim. We must not lose sight of the fact that there are allegations over and above a mere breach of the self-dealing rule. The claimants claim that not only has the Trust profited substantially as a result of the impugned transaction, but that the VPC shares are alleged to have been a core asset of Mintley. There is scant documentary evidence that the Trust was calling in the loan. Furthermore, there was no effort made by PLM, Rodger or Sheard to repay the loan by other means and Mitchell claims that, had he been asked, he could have come up with funds to repay it. This may be disputed by the defendants, but it is an issue of fact which may be proved at trial by the claimants.

21 I am unable to find from the authorities cited that the claimants must show a breach of duty over and above a breach of the self-dealing rule from which the defendant benefited personally, and even if I am wrong in that finding, the claimants allege a number of breaches of fiduciary duty over and above the rule against self-dealing.

22 The defendants further contend that Sheard is not a wrongdoer and so, in the first place, a derivative claim cannot be maintained against him, and in the second, the claim is not being stifled by the wrongdoers because Rodger, through the Trust, only holds 27% of the shares. As Sheard derived no benefit from the impugned transaction he cannot be said to be a party to stifling the claim. The defendants submit that when the matter came before me on the application for injunction the claimants presented their case on the basis that Sheard benefited from the sale of the shares. They have now withdrawn from that position and do not now

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allege that Sheard was dishonest or benefited from the transaction. The claimants maintain that they have not resiled from their original position and that the court is asked to draw inferences from the facts. They say that at the moment they cannot prove that Sheard benefited from the transaction, but they reserve their position in this regard.

23 I must say that at first blush I found the defendants' submissions in this regard attractive. If Sheard is not a wrongdoer the claim is not being stifled by the wrongdoers in that the only wrongdoer to be considered in the context of the exception to the rule in *Foss* v. *Harbottle* (8) is Rodger, who has only 27% of the shares. However, further consideration of the matter leads me to the conclusion that, at this early stage of the proceedings, it would be unjust for the claimants to be held out of the action on this ground. There is evidence that Sheard worked closely with Rodger in relation to Mintley. He was a party to a transaction which clearly is challengeable in equity. I prefer the claimants' submission that it would be wrong to find that where two directors together cause loss to a company by their breach of fiduciary duty in circumstances where it can at this early stage of proceedings only be shown that one director received a direct benefit, the other director (who may have received a benefit but he cannot be shown to have done so) can use his votes to forgive the very transaction which he carried out.

24 The defendants submit that, even on those findings, I ought to exercise my discretion not to grant permission to continue. They argue that an independent board of directors would not pursue these proceedings, and put forward five reasons for their contention.

25 First, the defendants say, the claim lacks merit. They submit that the claim has a fundamental weakness which any independent board would be bound to take into account, namely that the impugned transaction was approved and sanctioned by the directors of Mintley and that one of those directors, PLM, was the sole member and shareholder of the company. Given that the transaction was approved by PLM it is binding on Mintley and no claim can be maintained to challenge it. The defendants cite the case of *In re Duomatic* (7) in support of their argument.

26 In *Domoney* v. *Godinho* (6), Lindsay, J. dealt with *Duomatic* in this way ([2004] 2 BCLC 15, at paras. [43]–[45]):

> "[**43**] At a number of points in his arguments Mr. Green relies on the *Duomatic* principle. That is a reference to a short passage in the decision of Buckley, J. (as he then was) in *Re Duomatic Ltd.* [1969] 1 All E.R. 161, at 168, [1969] 2 Ch. 365, at 373, where he said:
>
> > 'In other words, I proceed on the basis that where it can be shown that all shareholders who have a right to attend and vote at a general meeting of the company assent to some matter

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which a general meeting of the company could carry into effect, that assent is as binding as a resolution in general meeting would be.'

[**44**] All the corporators, says Mr. Green, agreed that Mr. Domoney would resign, that Mr. Godinho was appointed a director, and that Mrs. Domoney would resign. But, of course, Mr. Godinho was not on the shareholders' register as at 14 June and is still not upon it. The *Duomatic* principle as framed looks to all members entitled to attend and vote at a general meeting. In other words, to registered shareholders, not beneficial owners. Companies invariably make a point of not being concerned with anything but legal ownership and, moreover, legal ownership as signified by their presence on the register of members.

[**45**] There is no doubt that argument to the contrary in some respects and some contexts is possible (see *Deakin* v. *Faulding*, *Specialist Group International Ltd* v. *Deakin* [2001] All ER (D) 465 (Jul), a decision of Hart, J.) but there is also strong authority to the contrary, namely that one looks solely to the register of members. In that respect I have in mind *Jalmoon Proprietary Ltd (in liq)* v. *Bow* [1997] 15 ACLC 233, a decision of the Supreme Court of Queensland, handed down on 13 December 1996. To like effect, it could be argued, is *Euro Brokers Holdings Ltd* v. *Monecor (London) Ltd* [2003] EWCA Civ 105 at [62], [2003] 1 BCLC 506 at [62], which, in the decision of Mummery, L.J., emphasises the word 'membership.'"

27 The defendants submit that whereas in particular contexts it may be permissible to look behind the veil of the register of members of a company, in a general company law context one looks to the actions of the registered shareholders and not the beneficial owners. They argue that even if the point remains in some doubt, any independent board of directors of Mintley would have the gravest reservations about pursuing expensive and risky litigation, hugely distracting to the operations and success of the company, in the hope of establishing an exception to the *Duomatic* principle.

28 How do the claimants deal with this submission? They say that in the circumstances of this case there is a compelling case for looking at the underlying beneficial interests and not the legal interests on the register of shareholders. When the beneficial interests are considered it is clear that neither Mitchell nor Jamison knew or approved of the impugned transaction. The defendants point to the decision in *Deakin* v. *Faulding* (5) referred to in the above passage from *Domoney* where Hart, J. said ([2001] All E.R. (D) 465 (Jul.), at para. 117):

"We are concerned here with the application of the equitable rule that a fiduciary must not profit from his office without the consent of the

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> corporators. Where a person (Peter Faulding) has an equity to compel a consent, I see no reason why equity should not have regard to the position of the beneficial as opposed to the legal owner in its application of the rule."

29 The claimants submit in this case they have an equity to compel the holding of consent and where the court is concerned with the application of equitable principles it should have regard to the position of the beneficial owners rather than that of the legal owners. They argue that the position is even stronger in this case where PLM held the shares pursuant to a declaration of trust which specifically limited its rights to vote as legal owner of the shares in the following terms: "We further undertake and agree at all times to use the voting and other powers attached to the shares in such manner and for such purposes as the Owner may from time to time direct." This latter point is, to my mind, the telling point and would, *prima facie*, allow the court to look behind the veil of the register to the actions and interests of the beneficial owners of the shares.

30 The defendants' second point on discretion relates to the costs of this action and the fact that they have so far incurred costs of almost £500,000. If the action were to fail, the claimants could still look to Mintley to pay their costs and those of the successful defendants. The defendants submit that no independent board would risk the costs of this litigation. Of course that question, as to costs, would be determined on the merits at the end of the case and it is by no means certain that the claimants would receive their costs from Mintley if they are unsuccessful. Furthermore, I do not consider that the question of costs should be the decisive factor in the circumstances of this case.

31 The defendants further point to the damage which would be done to Mintley's business in Sheard and Rodger being distracted by this litigation. It is submitted that Sheard is pivotal to the continuing success of Mintley's operations and point to various deals which demonstrate Sheard's value to the company. Be that as it may, again I do not consider that this should be the decisive factor in determining whether this case should progress.

32 The defendants' fourth submission is that Cabana is opposed to a continuation of these proceedings and that Jamison, who is the owner, through Gipsymoth, of 23% of the shares, is also opposed for the same reasons as Cabana. These are the reasons outlined in the last two paragraphs of this judgment. In his written submissions in reply Mr. Tregear has produced e-mails which have only just been disclosed and which show that the court was misled as to Jamison's reasons for his opposition to the action and that his real reason is that Sheard has threatened to pull out of Mintley if the action continues. Mr. Hollington has submitted a rejoinder to that reply urging me to disregard this new

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evidence. He submits it is improper for evidence to be produced in this way and produces a witness statement from the solicitor responsible for the late disclosure which answers the criticisms of the claimants that they should have seen the e-mails at an earlier stage. I do not intend to deal with this issue, save to make two comments. First, that it is obvious that, for whatever reason, Jamison is opposed to this litigation. Secondly, that the defendants have complained that the claimants are constantly changing their position in this suit. But this may well be inevitable in a case such as this where disclosure is ongoing. As facts emerge, parties can be expected to react to those facts.

33 As to Jamison's position, I can well understand that he may take a pragmatic approach to the continuation of this litigation. But in the light of the allegations made—and *prima facie* proved—of various breaches of fiduciary duty I do not think that the pragmatic approach of an individual shareholder should carry the day.

34 Finally, the defendants submit that, in the exercise of my discretion, I ought to take into account proceedings which were commenced in London by Mitchell following the hearing before me on October 10th, 2006. Reference has been made in the hearing of October 10th to assets of Mintley referred to as the "Stryker deal" and the "Kalmykia deal." Following that hearing, and as a result of disclosure by the defendants, Mitchell commenced the London proceedings against Sheard, Rodger and Jamison alleging that the defendants held these assets as trustees for Mintley. The defendants say that the claimants have changed their stance because originally they asserted that the Stryker and Kalmykia assets were assets of Mintley. This, say the defendants, demonstrates two things. First, that the claimants are prepared to say one thing in these proceedings and another in the London proceedings, to suit their case. Second, that it demonstrates that Mitchell's real interest in pursuing proceedings is for his personal interest and not for Mintley's interest. Not so, say the claimants. The London proceedings arise out of a chain of correspondence that commenced well after the start of these proceedings. Furthermore, that in asserting that Sheard and Rodger are trustees of the Stryker and Kalmykia assets the claimants are merely following assertions made on their behalf in that connection and are taking them at their word. Mr. Hollington has pointed out inconsistencies between those assertions and submissions and correspondence of the claimants.

35 Having carefully considered the defendants' submissions in this regard, I do not consider that they are sufficient, in themselves, to cause me to exercise my discretion so as to refuse the claimants' application to proceed.

36 It will be seen that, individually, I do not consider any of the five arguments put forward by the defendants as adequate reasons to cause me

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to refuse the claimants' application. I have also considered the reasons collectively, and I have come to the same conclusion.

37 It only remains for me to deal with the defendants' submission that the claimants have chosen to invest in a company as beneficial owners of the shares and not as legal owners, and they are bound by the corporate structure. However, the claimants do not accept that the corporate structure should be used to commit breaches of fiduciary duty and that the wrongdoers should be immune from the consequences of their actions. I have sympathy with the claimants' submission in this regard. Accordingly, I grant permission to the claimants to pursue this derivative action.

38 I can, in furtherance of my case management powers, also conveniently deal with the applications for summary judgment made by both the claimants and the defendants. I have all the material before me on which to make the relevant decisions. So far as the claimants' application is concerned, I am unable to say that the defendants have no real prospect of defending the claim.

39 So far as the defendants' application is concerned, Mr. Hollington has submitted that even if I grant permission to proceed I should still give the defendants summary judgment on the grounds he has submitted and, in particular, on the argument that he raised in respect of the *Duomatic* principle. I hope that I have demonstrated in this judgment that I consider that there are serious issues to be tried between the parties, and that I am not satisfied that the claim has no real prospect of success.

40 In the event, I do not intend to give summary judgment to either the claimants or the defendants.

Orders accordingly.

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