In The Supreme Court of Bermuda

COMMERCIAL COURT

2009: No. 127

BETWEEN

WESTPORT TRUST COMPANY LIMITED
(as trustee of the Laylash Trust)

Petitioner

-v-

1. PARAGON TRUST LTD
(as trustee of the Hale Trust) First Respondent

2. C-HOLDINGS LTD

Second Respondent

3. CARL PAIVA

Third Respondent

RULING
(in Chambers)

Date of Hearing: May 17, 2010
Date of Ruling: June 11, 2010

Mr. David Kessaram, Cox Hallett Wilkinson,
for the Petitioner
Mr. Timothy Marshall, Marshall Diel & Myers,
for the Second Respondent

Introductory

1. The Petitioner presented a minority shareholder's oppression petition under section 111 of the Companies Act 1981 on May 12, 2009. The Petitioner is the trustee of a trust of which the principal beneficiary is Lois Wilson and the First Respondent is trustee of a trust settled for the benefit of the Carl Paiva, who was added as Third Respondent by way of amendment on May 21, 2009[1]. Each trust owns shares in the Second Respondent ("the Company"). The Petition complains that Wilson invested in the Company on the basis that both she and Paiva would be entitled to manage the Company and benefit equally from it; it is alleged that Paiva has wrongfully ousted her from any further role in managing the Company. The present interlocutory applications arise out of this substantive action.

2. The first application is the Petitioner's Summons dated October 5, 2009 seeking the following relief:

> "*an Order that the Second Respondent may be restrained from applying or allowing its funds or the funds of its subsidiary, C Travel Company Limited, to be applied in the defence of these proceedings...*"

3. The second application is the cross-application of the Second Respondent made by Summons dated February 22, 2010 for an Order that:

> "*1. The Second Respondent be at liberty to use its funds in defence of these proceedings.*"

4. These cross-applications appear to present for consideration for the first time in Bermuda the question of when it is appropriate or inappropriate for the corporate respondent to a minority shareholder oppression petition to expend its funds in responding to what the petitioner contends is a dispute between two shareholders.

The Petition

5. The Petition alleges that the Company was incorporated on November 9, 2009 with the Petitioner and the Respondent each holding 30,600 shares. Its business is an investment holding company whose main assets include the shares of C Travel Co. Ltd. ("C Travel") and a leasehold interest in C Travel's business premises. Wilson and Paiva founded C

[1] Unless otherwise indicated, the Petition as amended is hereafter referred to as "the Petition".

Travel, with Wilson contributing financial and organisational skills (she is a chartered accountant) and Paiva travel industry expertise. It was mutually understood that the two would jointly manage and benefit from the Company. Wilson and Paiva both personally guaranteed bank loans to the Company in respect of the lease and related renovations.

6. On November 14, 2008 Wilson was unilaterally removed from the Boards of, *inter alia*, the Company and C Travel at the instigation of Paiva, who wrongly characterised Wilson's email of September 25, 2008 as an offer to resign. It is also alleged that this removal "*was not prompted by any business consideration or any solicitude for the welfare of the Company*" (paragraph 20). So it is clear on the face of the Petition that although the principal allegations are directed at the Third Respondent (and by implication the First Respondent as well), the suggestion that the Board accepted Wilson's purported resignation without regard to the interests of the Company is an allegation which only the Company can evidentially answer with any credibility. It is also clear from the Petition's Prayer, that the relief sought potentially impacts upon the Company as well. Paragraph 1 and 2 state as follows:

> "*1.That the First Respondent and/or the Second Respondent and its subsidiaries and/or the Third Respondent be ordered to purchase the shares of your Petitioner on an independent valuation to be ordered by the Court but in any event to be conducted on the basis of the market value of the assets of the Company.*
> *2. Alternatively, an order that the Company be wound up.*"

The Evidence

7. The Second and Third Wilson Affidavits were sworn in support of the Petitioner's injunction application and in reply to the opposing First Hanson Affidavit, respectively. Second Wilson complains that although the Petition is directed primarily at the First and Third Respondents, the Company has insisted on actively defending the present proceedings. Six of the seven affidavits filed in response to the Petition including Paiva's Affidavit have been filed by the Company's attorneys, it is asserted, making it clear that the Company's funds are being expended on a shareholder dispute.

8. Second Hanson is sworn by a director in opposition to the injunction application. Firstly it is asserted that the directors consider they cannot adopt a passive role in the present proceedings because (a) the relief sought by the Petitioner threatens the existence of the Company, and (b) serious allegations are made about the Company's role in the departure of Ms. Wilson. Secondly, the merits of the central complaint about the removal of Wilson from the Board are challenged, it being explained that the Board has a majority of independent directors who made an objective decision on November 13, 2008. Thirdly, the deponent points out that neither of the two shareholder protagonists have a controlling interest in the Company. There are other shareholders whose interests also fall to be taken into account who have yet to be served with the present proceedings.

9. Third Wilson by way of reply to Second Hanson contends that much of the latter Affidavit consists of argument rather than evidence. The deponent exhibits a copy of the guarantee signed by herself and Paiva in respect of the Company's debts and asserts that she and Paiva together have controlling interests in the Company. She also deposes that she and Paiva were two of only three directors of C Travel, the operating company.

Factual findings

10. In my judgment the Petition raises issues which primarily turn on the assertion that Wilson and Paiva agreed to run the business of the Company on a quasi-partnership basis and that the Board's purported decision to, *inter alia*, accept her "resignation" as a director constituted unfair prejudice. It is nevertheless also clear that evidence from the Company as to the rationale underlying the relevant decisions is likely to be relevant to resolving the dispute between the shareholders as to the basis on which the Company was initially set up. To date it appears that the Company has been playing an active role in responding to the Petition with the Respondent shareholder playing a merely passive role.

11. It is a matter of judgment having regard to the applicable legal principles whether the Company ought to be allowed to actively participate in the resolution of the shareholder dispute. However, it is unarguably clear that if the shareholder dispute is resolved in favour of the Petitioner and relief is sought against the Company, the Company must be able to fully participate in any application for such relief.

12. As far as the interests of "independent" shareholders are concerned, such interests will only be obviously engaged at the same stage as the Company's interests are engaged by the prospect of relief being sought against the Company itself. However, Mr. Marshall rightly pointed out that such shareholders, although notified of the present proceedings, were told that the Company would be defending them. If the injunction sought is granted, then clearly such shareholders should be notified of such fact and given an opportunity to participate in the present proceedings at their own expense, even if only in an observer capacity.

13. Based on the evidence presently before the Court, it appears to be undisputed that the Petitioner and the Respondent between them were majority shareholders capable of jointly controlling the Company. Accordingly, the independent shareholders are collectively themselves a minority incapable of compelling the directors of the Company to act in their collective interests, without support from one of the two shareholder protagonists.

Legal findings

14. Section 111 of the Companies Act 1981 provides as follows:

"Alternative remedy to winding up in cases of oppressive or prejudicial conduct

111 (1) Any member of a company who complains that the affairs of the company are being conducted or have been conducted in a manner oppressive or prejudicial to the interests of some part of the members, including himself, or where a report has been made to the Minister under section 110, the Registrar on behalf of the Minister, may make an application to the Court by petition for an order under this section.

(2) If on any such petition the Court is of opinion—

(a) that the company's affairs are being conducted or have been conducted as aforesaid; and

(b) that to wind up the company would unfairly prejudice that part of the members, but otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up,

the Court may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, whether for regulating the conduct of the company's affairs in future, or for the purchase of the shares of any members of the company by other members of the company or by the company and, in the case of a purchase by the company, for the reduction accordingly of the company's capital, or otherwise.

(3) Where an order under this section makes an alteration in or addition to any company's memorandum or bye-laws, then, notwithstanding anything in any other provision but subject to the provisions of the order, the company concerned shall not have power without the leave of the Court to make further alteration in or addition to the memorandum or, bye-laws as so altered or added to accordingly.

(4) An office copy of any order under this section altering or adding to, or giving leave to alter or add to, a company's memorandum or bye-laws shall, within fourteen days after the making thereof, be delivered by the company to the Registrar for registration; and if a company makes default in complying with this subsection, the company and every officer of the company who is in default shall be liable to a default fine."

15. There is nothing on the face of these provisions which suggests that the Company should not be actively involved in the defence of a petition filed under the section. Indeed, as I indicated on the first return date of the Petitioner's injunction application, doubting the merits of the present application, my experience of similar petitions presented in Bermuda suggested that the company was invariably involved. This view finds support on a cursory review of reported Bermudian cases under section 111 of the Companies Act 1981[2]. However, Mr. Kessaram cited a compelling array of persuasive authority in

[2] E.g. : *Re Bermuda Cablevision Ltd.* [1996] Bda LR 65; *Chiang and Pacific Challenge Holdings Ltd.-v- Kistefos Investment A.S.* [2002] Bda LR 50; *Sino-JP Fund Company Ltd.-v- Pacific Electric Wire & Cable Company Ltd. et al* [2006] Bda LR 51.

support of the proposition that this Court possessed and should exercise the discretion to restrain the Company from expending its corporate resources to defend a shareholder dispute.

16. The proposition that a company ought not expend its funds save for legitimate corporate purposes was supported as a broad general principle by reference to the principle articulated in *Pickering-v- Stephenson* (1872) L.R. 14 Eq 322 at 340[3], "*that the governing body of a corporation, that is in fact a trading partnership, cannot, in general, use the fund of the community for any purpose other than those for which they were contributed.*" However, the narrower principle of the impropriety of a company expending its funds to respond to a section 111 petition was supported by a number of *dicta*, most robustly the following observations of Harman J in *Re a Company No. 004502 of 1988, ex parte Johnson* [1991] BCC234 at 236-237:

> " *The train of authority being well established, it seems to me quite clear that, if it is shown that directors of a company have been causing the company's money to be spent on financing the company's resistance either to a 'pure' sec. 459 petition or, according to Plowman J in Re A &BC Chewing Gum and myself in Re Hydrosan, in financing the company's resistance to a member's winding-up petition based on the just and equitable ground, the court should prevent such expenditure. Such expenditure is a misfeasance, there is no excuse for it in law and it is not a question of an arguable case being raised showing that it may be right to permit misfeasances. Misfeasances are not matters that are permitted by the courts and there is no question of an arguable case at all.*"

17. Implicit from a reading of the earlier portions of Harman J's judgment is that the company's participation at its own expense is not justified where it is "*a nominal party to the sec 459 petition, but in substance the dispute is between two shareholders*": per Hoffman J in *Re Crossmore Electrical and Civil Engineering Ltd.* (1989) 5 BCC 37 at 38. The question of whether or not "*in substance the dispute is between two shareholders*" clearly turns on the facts of each case, a point which the principal authority relied upon by Mr. Marshall clearly illuminated. The following principles apply to deciding whether a company's participation in the English equivalent of our own section 111 petitions[4], according to Lindsay J in *Re a company (No. 1126 of 1992)* [1994] 2 BCLC 146:

> "*Firstly, there may be cases (although it is unlikely nowadays when wide objects clauses are the norm) where a company's active participation in or payment of its own costs in respect of active participation in a s459 petition as to its own affairs is ultra vires in a strict sense.*
>
> *Secondly, leaving aside that possible class, there is no rule that necessarily and in all cases such active participation and such expenditure is improper.*

[3] Per Sir John Wickens, Vice-Chancellor,

[4] Section 459 of the Companies Act 1985 (UK), a modern derivation of section 210 of the UK Companies Act 1948 upon which our section 111 is based..

Thirdly, that the test of whether such participation and expenditure is proper is whether it is necessary or expedient in the interests of the company as a whole (to borrow from Harman J in ex p Johnson).

Fourthly, that in considering that test the court's starting point is a sort of rebuttable distaste for such participation and expenditure, initial scepticism as to its necessity or expediency. The chorus of disapproval in the cases puts a heavy onus on a company which has actively participated or has so incurred costs to satisfy the court with evidence of the necessity or expedience in the particular case. What will be necessary to discharge that onus will obviously vary greatly from case to case.

Fifthly, if a company seeks approval by the court of such participation or expenditure <u>in advance</u> then, in the absence of the most compelling circumstances proven by cogent evidence, such advance approval will obviously vary greatly from case to case."

18. Although the fifth point is not applicable to the present case, I find the above statement of principles to be highly persuasive and the fourth point to be of particular relevance to the present case. The starting point is for this Court to be sceptical about the need for the Company's participation.

19. How injunction applications such as the Petitioner's present application are to be approached evidentially is further illustrated by another case on which Mr. Marshall relied. In *Arrow Trading & Investments Est. 1920 et al –v- Edwardian Group Ltd. et al* [2003] EWHC 2863 (Ch), Sir Francis Ferris opined as follows:

"*17. The essential question in this case, as it seems to me, is whether it is right to say that the company has a separate and independent position on the issue of remuneration…The essence of the of the petitioners' claims is that the petitioners as shareholders have been unfairly treated as a result of the decisions of the majority. Those decisions are essentially the decisions of individuals, whether in their capacity as directors or as shareholders. They are embodied in resolutions and the like which are technically describable as 'acts of the company', but the reality of the position is that what is complained of is treatment resulting from a decision or series of decisions made which have caused the company to endorse what is said to be the unfair remuneration policy.*

18. The particular aspect of the matter on which Mr. Hart and Mr. Morley seek to put their-or as they would put it the company's- position before the court is to explain the steps by which at any rate in recent years the company has arrived at the decisions which have been implemented as its remuneration policy. There can be no doubt that each of Mr. Hart and Mr. Morley has knowledge, by virtue of participation, of facts and events which are of great materiality to the issues

which the court will have to decide. They are undoubtedly relevant witnesses. What I am unable to understand is why the fact that Mr. Hart and Mr. Morley have this evidence….means that the consequence is that the company has a separate and independent position. Mr. Hart and Mr. Morley can readily put their evidence before the court by being called by on or other of the parties. "

20. This approach, which I adopt, also suggests that this Court ought to adopt a very narrow view of what constitutes an independent company position requiring the Company's participation in the present shareholder dispute. Clear evidence of an independent Company position should be adduced to justify its active participation (using company funds) in a shareholder dispute.

Findings: application of relevant legal principles to relevant facts

21. The substantive complaint made by the Petitioner which must be proved before any relief can be sought (if at all) against the Company is that: (a) Wilson and Paiva established the Company as a quasi-partnership, and (b) that Wilson's removal from the Company's Board at the instance of Paiva is unfairly prejudicial to her as a minority shareholder, absent the acquisition of her shares. This is a shareholder dispute in relation to which "independent" directors such as Hanson have potentially relevant evidence to give and which can be relied upon by either the Petitioner or the First and/or Third Respondent.

22. In my judgment there is no or no clear evidence of any independent Company position on either limb of the relevant dispute. There can be no tenable Company position as to the basis of its own formation. And to the extent that individual directors other than Paiva wish to deny that he influenced them to remove Wilson from the Board, such evidence would be: (a) probative of the motivations of the relevant actors as directors and/or shareholders, (b) substantively supportive of the First and Third Respondent's response to the allegations made primarily against them but (c) *not* demonstrative or sufficiently of any distinct and separate Company position.

23. In any event, the fact that the Company has filed the bulk of the evidence in response to the Petition to date with the main shareholder target of the Petition seemingly riding on the Company's coat-tails makes it impossible to objectively view the Company's involvement as being substantially in aid of a truly independent position.

24. That said, the relief sought would potentially engage the interests of the Company as a whole if and when such relief is pursued. The Company is, on the face of the Petition, more than a merely nominal Respondent. It is only after careful analysis that it becomes obvious that a line may properly be drawn between the principal dispute and the relief which may be sought if such dispute is resolved in the Petitioner's favour.

25. Finally, it must not be forgotten that the principles relied upon by the Petitioner in support of the injunction to which I find it is entitled have seemingly never before been applied by this Court. Accordingly, and without deciding this issue which has not yet been addressed in argument, it is understandable that the Company launched itself

headlong into the present proceedings without seemingly averting to the propriety of expending its funds in the present manner.

Conclusion

26. The Plaintiff is entitled to an injunction restraining the Second Respondent from expending its funds on defending the merits of the Petition, without prejudice to: (a) its right to actively participate in any proceedings herein in which any relief against the Company is sought, and (b) its right, if so advised, to notify independent shareholders of the result of the present application in light of their previous advice to shareholders that the Company would be defending the Petition.

27. Unless either party applies within 21 days by letter to the Registrar to be heard as to costs, the costs of the present application shall be awarded to the Petitioner to be taxed if not agreed.

Dated this 11th day of June, 2010 _____
KAWALEY J