In The Supreme Court of Bermuda

COMPANIES WINDING-UP

2008: No 162

BETWEEN:-

ALLISON THOMAS

-and-

RICARDO SWAN

Petitioners

-v-

FORT KNOX BERMUDA LTD.

-and-

TROY SYMONDS

-and-

SHARI POE

Respondents

JUDGMENT

(In Court)

Date of hearing: 13th and 14th January 2014
Date of judgment: 26th February 2014

Mr Mark Diel, Marshall Diel & Myers, for the Petitioners
Mr Ben Adamson, Conyers Dill & Pearman, for the Respondents

Introduction

1. The First Petitioner is a founder, shareholder, and former director of the First Respondent ("the Company"). In his capacity as a member of the Company he has issued a petition in which he applies for relief pursuant to section 111 of the Companies Act 1981 ("the 1981 Act"). This is on the ground that the affairs of the Company are and have been conducted in a manner oppressive or prejudicial to his interests as a member.

2. The Second Petitioner is also a founder member of the Company, of which he is a director. However he took no part in the hearing.

3. The Company takes a neutral position as regards the petition. However the petition is opposed by the Second and Third Respondents. They are both directors of the Company, in which they hold a majority of the shares. The Second Respondent was another founder member. There was a fourth founder, Hugh Hollis. He remains a director and shareholder of the Company but has taken no part in this dispute.

History

4. The Company was incorporated as a telecoms start up on 25th June 1999. It was, on the First Petitioner's account, his idea. He left his job with BELCO to set it up and recruited the other three founders. The Company took out a bank loan of $275,000 as start-up capital, for which the founders all provided security: eg the First Petitioner supplied the Bank with the deeds to his house.

5. Shares were issued in 2 tranches in July 1999 and December 1999. They were allotted at their par value of $0.10 per share as follows: 400,000 to both the First Petitioner and the Second Respondent, 300,000 to Mr Hollis and 200,000 to the Second Petitioner. The allotments were recorded in the Company's register of members.

6. A share option agreement dated 1st September 1999, signed by all four members of the Company, provided that no member should hold more than one million shares or 25% of the Company.

7. On 9th December 1999 the Board formally appointed roles to the Company members. The Second Respondent was made President and Chief Executive Officer; the First Petitioner was made Vice President and Chief Operating Officer; the Second Petitioner was made Vice President and General Manager; and Mr Hollis was made Chief Information Officer.

8. The Petitioners and the Second Respondent had been working for the Company since its inception. At a directors' meeting on 13th September 2000 it was resolved to issue in lieu of salary further shares at the rate of $0.10 per share as follows: 300,000 shares to the First Petitioner, 180,000 to the Second Petitioner, and 140,000 to the Second Respondent. The allotments were recorded in the Company's register of members.

9. From an early stage, the Company sought to bring in additional investment and expertise. Indeed this was discussed at a shareholders general meeting as far back as 2nd February 2000. Accordingly, on 10th May 2000 two additional directors were appointed: Raymond Dill and Phillip Butterfield.

10. A detailed private placement memorandum was prepared by a local law firm. This offered 1 million common shares in the Company at a price of $2.45 with a minimum subscription of $30,000 per shareholder. The closing date was 30th September 2000.

11. An offering memorandum for the Company was also prepared. This offered 1 million shares of common stock at $2.45 per share with a minimum

subscription of 12,245 shares per shareholder. The offering period was stated to end on 30th November 2000.

12. The Board discussed potential investors. They approached one such investor, Credit Union with an investment pitch. Credit Union was interested in investing, but not on terms which were acceptable to the Company.

13. It was in September 2000, at the invitation of the Second Respondent, that the Third Respondent became involved with the Company. This was on the basis that she was someone with business experience who would help run the Company and would be prepared to invest in it.

14. On 24th October 2000 the Third Respondent purchased 60,000 shares at a rate of $2.45 per share at an overall price of $147,000. The purchase was recorded in the Company's register of members.

15. On 13th December 2000 the Third Respondent was appointed to the position of manager, human resources and administration, at a salary of $70,000 per annum, part of which, her written offer of employment stated, would be deferred. There was an option to convert deferred payments after 12 months of employment to common shares at a rate of $2.15 or less, to be determined by the Board, up to a maximum of $40,000. In fact the Third Respondent took none of her salary in cash for the first 20 months of her employment.

16. Shortly after her employment began it became clear to the Third Respondent that the Company needed additional cash on an ongoing basis in order to remain viable. She was prepared to lend it the money. She therefore permitted the Company, largely through the agency of the Second Petitioner, to use her credit card to fund its operating expenses, and made various bank transfers for its benefit. I am satisfied that all the directors were aware, at least in general terms, of these arrangements.

17. The Third Respondent required some form of security for the loan monies. On 10th May 2001 the Second Respondent as CEO therefore wrote to her as follows ("the 10th May 2001 letter"):

> Dear Mrs. Poe
>
> The purpose of this letter is to set out the terms agreed for the convertible debenture to be purchased by you from time to time from Fort Knox Bermuda Ltd.
>
> Interest rate: Bank rate plus four percent (4%) payable semi-annually
>
> Conversion: The principle sum of the debenture must be converted to common equity at a rate of $2.45 per share.
>
> Term: The conversion of the debenture to equity can only be completed with the consent of the company.
>
> If you consent to these terms, please so indicate where indicated below.
>
> Sincerely
>
> [Signature]
>
> Troy E. Symonds
> CEO
>
> Agreed this 10th day of May 2001:
>
> [Signature]
>
> Shari L. Poe

18. Neither the 10th May 2001 letter nor its terms were recorded at the next directors' meeting, which took place on 17th May 2001, or at any subsequent directors' meeting. The First Petitioner submits that this is evidence of a sinister ulterior purpose. The legal effect of the letter was in dispute before me and I shall consider that question later.

19. In February 2002 the Third Respondent in her capacity as "*Manager, Administration*" wrote to the First Petitioner setting out the terms of his employment. His salary was expressed to be $90,000 per annum, which equated to $7,500 per month. Of this sum, $3,000 was actually payable monthly, with a deferred monthly payment of $4,500.

20. Attached to the letter was a copy of the Company's employee manual. The letter stated that the manual contained those terms of the First Petitioner's employment that were not included in the letter, eg as to notice periods. On that point, the manual stated:

> Should it become necessary for the company to terminate employment for reasons other than cause, … monthly paid employees will receive one month's notice or payment in lieu of notice.

21. The First Petitioner signed an acknowledgment as follows:

> I have read and understand the terms of employment set out in the above letter. I have also been given a copy of the Fort Knox Bermuda handbook, which covers in detail all areas of my employment with Fort Knox Bermuda. I have read the Handbook and agree to the terms and conditions stated therein.

22. It is curious that the letter is dated 27th February 2002 whereas the acknowledgment is dated 14th February 2002. However the point was not explored before me and is most likely due to a clerical error. There was no suggestion that in being supplied with written terms of employment the First Petitioner was treated any differently to the other shareholder employees. They were no doubt issued in order to help ensure that the Company was run in a more professional manner.

23. Deferred payment and compensation packages for the Petitioners and the Second Respondent were approved by resolution of a directors' meeting on 15th February 2002. They provided that, for the period 1st September 2000 to 31st August 2001, deferred payments due to the Petitioners and the Second Respondent should be converted into shares at a rate of $1.25 per share as

follows: 49,600 shares to the First Petitioner, 43,600 shares to the Second Petitioner, and 57,600 shares to the Third Respondent. Those allotments have not been entered on the Company's register of members due to confusion as to whether they were approved by the directors – as stated above, I am satisfied that they were approved.

24. The directors' meeting further resolved that, for the period 15th March 2001 to 14th March 2002, deferred payments due to the Third Respondent should be converted into shares at the rate of $2.15 per share, yielding 32,558 shares. A further 20,000 shares were granted to the Third Respondent in recognition of the continued financial support from her and as compensation for the level of risk that she had thereby assumed. The First Petitioner approved all the resolutions passed at that meeting. The register of members was amended to reflect the allotment of the 20,000 shares but not, apparently, the 32,558 shares.

25. At a directors' meeting on 25th February 2003, the Second Respondent reported that the Company's Bank had expressed concerns about the size of the convertible debt on the Company's books and that the Third Respondent had agreed to convert $300,000 of that debt that into equity. It was therefore resolved:

> that $300,000 of the convertible debenture due in 2006 be converted to common shares at $1.

26. Both Petitioners were present at the meeting, as was the Third Respondent, and neither Petitioner objected to this course. I take the reference to the "*convertible debenture*" to be a reference to the 10th May 2001 letter.

27. In May 2003 the Third Respondent was appointed as a director of the Company.

28. From around 2003, the First Petitioner started to have discussions with the Second Respondent about leaving the Company. His relationship with the Second and Third Respondents evidently deteriorated. They appear to have

become the driving force behind the Company, and I infer that the First Petitioner felt increasingly marginalised.

29. For the Third Respondent, the position of the First Petitioner reached a tipping point on 14th July 2005 when there was a power failure at the Company's offices. The back-up generator failed to start because its batteries were flat. This would have had potentially catastrophic consequences for the Company had any of its disaster recovery clients tried to access their back-up computers at the Company's offices during the outage. Maintenance of the generator was the responsibility of the First Petitioner. He explained in evidence that the generator had not been "*turned over*" for a few months because the person who used to maintain it had withdrawn his services and the Company was unable to find anyone to replace him.

30. The event triggered a letter from the Third to the Second Respondent dated 17th July 2005 in which she set out a series of complaints against the First Petitioner and concluded with the statement:

> Our responsibility as officers and directors of Fort Knox Bermuda is to the company itself, not to the individual officers. With that firmly in focus, I am of the opinion that we have no choice but to terminate Allison's employment with the firm, unpleasant as that process may be. I am convinced that the viability of the company is at risk.

31. No action was in fact taken with respect to the letter, which was not copied to the First Petitioner. The Second Respondent was cross-examined about this and accepted that no written warnings were issued to him. He said that the First Petitioner was not the type of employee to whom you would put things in writing and expect them to go easily. But he said that he was in regular contact with the First Petitioner and that each knew how the other felt. I am not satisfied that any of the concerns raised in the letter were raised with the First Petitioner: certainly none were raised in a formal, disciplinary context.

32. The episode of the letter bears eloquent testimony to the deterioration of the relationship between the First Petitioner on the one hand and the Second and Third Respondents on the other.

33. The First Petitioner, for his part, was concerned about the state of the Company, and in particular what he saw as its poor financial controls. These were in his view the responsibility of the Third Respondent, who was by now its Chief Financial Officer.

34. Matters came to a head in October 2005. The Third Respondent was concerned that the Company was indebted to her in a substantial amount that it was in no position to pay. By a letter to the Second Respondent dated 14th October 2005 she proposed the following arrangement:

> I hereby agree to convert all of the debt owed to me by Fort Knox Bermuda Ltd. to equity at the rate of $1 per share. The total amount of the debt is $569,934.
>
> The company agrees to repurchase the shares at a share price of no less than $1.50. I further agree to not require the company to repurchase any of the shares for a period of three years, except under the following circumstances:
>
> (1) I were no longer to be employed by the Company
>
> (2) Troy Symonds were to cease to be President and CEO of the Company
>
> (3) There were to be a transfer of ownership of forty per cent (40%) or more of the Company's stock.

35. A directors' meeting was held on 17th October 2005 at which the Third Respondent's proposal was one of the items under consideration. The minutes record:

> Discussion was then opened regarding the Company's debt to Shari Poe and the terms under which she would be willing to convert it all to equity.

> Ms. Poe stated the terms she was willing to accept, a copy of which is attached. Discussion ensued.

36. The Petitioners objected to the proposal. The Second Respondent asked them what options they believed were available. The First Petitioner said that he could vote "*no*" and the Second Petitioner said that the Company could be wound up.

37. The proposal was approved by three votes to two. Those in favour were the Second and Third Respondents and Mr Butterfield, who was not present but whose proxy vote was cast by the Second Respondent. Those against were the Petitioners.

38. Once the proposal was approved the Petitioners walked out of the meeting. The Second Respondent then presented a written interim report on the company. The report was accepted, with his recommendations to be voted on and discussed at the next Board meeting.

39. Amongst the matters which the report addressed was the future of the First Petitioner with the Company:

> A.T, whilst very capable is the most despondent member of the team and is progressively less involved in the management of FK. He has expressed a need to sell his stock and move on. He has been directly involved with all of the major losses for the company including; non-payment of insurance- $150k loss; Failure of the generator- $5k; C&W law suit $120k loss. It is my observation that whilst able to discuss future opportunities, he is not willing to commit to the implementation of any plan.
>
> It is my recommendation that we explore ways of allowing A.T. to exit the company as Vice President and Chief Operations Officer.

40. The Petitioners instructed attorneys, who wrote to the Company on 20th October 2005 complaining of "*certain procedural and legal irregularities*" in the conduct of the meeting, and in particular the conversion of the debt owed to the Third Respondent into equity.

41. As a result of the concerns raised in the letter, a further directors' meeting was held on 24th October 2005 at which Mr Butterfield was present by telephone. The Third Respondent's proposal to convert debt into equity was again put to the directors and was approved by the same margin. They resolved:

> 1) to accept the proposal from Mrs Poe in her letter of October 14th 2005 a copy of which is attached and forms part of the minutes of the meeting;
>
> 2) to issue and allot to Mrs Poe 569,934 of common shares (and to amend the register of members accordingly) in satisfaction of the debt owed to her in the amount of $569,934 of common shares on the basis that the company has the obligation to repurchase the shares from her in three years' time at $1.50 per share; however, in the event that Mr Troy Symonds was to be replaced as President and CEO, or that Mrs Poe were no longer to be employed by the company, the company would have to repurchase the shares at $1.50 per share at the time that either of these events occurred.

42. The First Petitioner submits that the meaning and intent of the resolution was to allot to the Third Respondent 569,934 common shares over and above the 300,000 common shares which had been allotted to her in February 2003. In other words $569,934 of debt would be converted into 869,934 common shares, with the allotment of two tranches of 300,000 shares for the same $300,000 of debt. This, he submits, is the natural meaning of the directors' resolution and the accounts given of the meeting by both the Second and Third Respondents in their witness statements.

43. The First Petitioner further submits that this was pursuant to a fraudulent scheme to give the Second and Third Respondents control of the Company. A further 569,934 common shares, once issued to the Third Respondent, would mean that her shares when combined with the Second Respondent's shares would form a majority of the shares which had been issued to shareholders. Without that allocation the Second and Third Respondents were dependent upon the votes of Mr Butterfield to outvote the Petitioners.

44. When cross-examined, the Second Respondent accepted that in October 2005 the Third Respondent's position was that she was owed $569,934. He said that at the date of the meeting the numbers were known and no one disputed the debt.

45. The Third Respondent explained in oral evidence how the $569,934 was calculated and that it included the $300,000 that was converted into shares in 2003. She did so with the aid of two schedules, marked A and B, which she had prepared from the Company's records prior to the 17th October 2005 directors' meeting, which gave particulars of the debt. She could not remember whether she had taken the schedules into the directors' meeting and did not present supporting documentation for them to the meeting. However the supporting documentation was in evidence before me and was not challenged.

46. On the Third Respondent's case, she had only expected to be allocated an additional 269,934 shares on top of the 300,000 shares with which she had already been issued. The additional shares would not have been sufficient to give her and the Second Respondent, when voting together, a majority vote among the shareholders.

47. The Third Respondent explained that the repurchase price of $1.50 per share was intended to reflect interest accrued from 2001 when she first loaned the Company money until 2008 when the Company could be required to repurchase the shares. She described this as a prospective 50% return over 7½ years, or around a return of 6% or 7% per year. The First Petitioner characterised it instead as a 50% return over 3 years.

48. Both the Second and Third Respondents reject the allegations of fraud.

49. The Respondents again walked out after the vote on the allocation of shares. The written interim report was reviewed again and its recommendations were accepted. The minutes record:

> After discussion by the board, and particularly in light of the two meetings where Mr Thomas had left in the middle expressing strong views, the directors considered that it was inappropriate for Mr Thomas to continue to serve as Vice President of the Company. It was therefore FURTHER RESOLVED to replace Mr Thomas as Vice President by appointing Shari Poe as Vice President with effect from the end of the meeting.

50. On 1st November 2005, the Second Respondent wrote to the First Petitioner terminating his employment with the Company.

> In reflection of the past years' accomplishments and failures, I have concluded that you are not positioned to serve the company adequately moving forward. Over the past few years the inefficiencies that have been caused by our inability to work cohesively have caused the company tremendous loss both in terms of revenue and opportunity. As I prepare for the upcoming challenges, I am charged with installing a team of professionals who can deliver upon the business plan and the demands of this highly competitive environment. I do not believe that you are suited for this team.
>
> As a result, I have decided that it is in the best interests of all concerned to terminate your employment with effect from today. You will be paid salary and benefits up to and including 1 months' salary in lieu of notice in accordance with your entitlement under the Employment Act 2000 …

51. The First Petitioner remained a director of the Company until the annual general meeting of the Company on 12th August 2009. Besides the First Petitioner, those present and voting were the Second and Third Respondents and (by proxy) Mr Hollis. Despite the First Petitioner's objections, the meeting resolved to appoint a slate of directors for the coming year that did not include him.

52. The Company has failed to maintain an accurate and up to date register of members. It is not clear whether the shares allocated to the Third Petitioner at the October 2005 directors' meetings were in fact issued to her, ie that her name was entered on the register of members as the holder of those shares. This is important, as the holder of a share is the one (and only one) whose

name is registered as the holder in the register of members. See In re DNick Holdings plc [2013] 3 WLR 1316, Ch D, at para 17 – 19, which was recently applied by this Court in MFP-2000, LP v Viking Capital Limited and another, unreported, 7th February 2014.

53. An amended draft of the 14th October 2005 letter was drawn up. It was dated 12th January 2006. Although a signed copy of the draft was not in evidence, the Second and Third Respondents both told me that the Third Respondent had agreed to its terms. It contained the following passage:

> In light of the Deferred Compensation Agreement that you, Allison Thomas and Ricardo Swan signed, under which management employees receiving deferred compensation cannot own more than a maximum of 25% of the shares in the Company, I agree to take 126,334 of the shares above as Class B non-voting common shares. I understand that the Class B shares to be issued will have equal status with Class A voting common shares with respect t the payment of dividends.

Section 111

54. Section 111 of the 1981 Act is headed "*Alternative remedy to winding up in cases of oppressive or prejudicial conduct*". It provides in material part:

> (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 … 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,
>
> (3) 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.

55. Thus, as Ground CJ stated in DE Shaw Oculus Portfolios LLC v Orient-Express Hotels Ltd [2010] Bda LR 32, SC, at para 64:

> In order to achieve relief under section 111 of the Act the petitioners have to show that, were it not for the existence of the statutory remedy, it would otherwise be just and equitable to wind up the company.

56. Section 111 is concerned with the rights of shareholders. The conduct complained of must be oppressive or prejudicial to the interests of the member as a member. It is not enough that it is prejudicial to his interests in some other capacity, eg as a director or employee.

57. Section 111 of the 1981 Act is similar to section 994 of the Companies Act 2006 in England and Wales. Section 994, like its predecessor, section 459 of the Companies Act 1985, uses the phrase "*unfairly prejudicial*" rather than the phrase "*oppressive or prejudicial*", which occurs in the Bermudian legislation. As Hoffmann LJ explained in Re Saul D Harrison & Sons plc [1995] BCC 475, EWCA, at 488 C – D:

> "Unfairly prejudicial" is deliberately imprecise language which was chosen by Parliament because its earlier attempt in s. 210 of the Companies Act 1948 to provide a similar remedy had been too restrictively construed. The earlier section had used the word "oppressive", which the House of Lords in Scottish Co-operative Wholesale Society v Meyer [1959] AC 324 said meant "burdensome, harsh and wrongful". This gave rise to some uncertainty as to whether "wrongful" required actual illegality or invasion of legal rights. The Jenkins Committee on Company Law, which reported in 1962, thought

> that it should not. To make this clear, it recommended the use of the term "unfairly prejudicial", which Parliament somewhat tardily adopted in s. 75 of the Companies Act 1980. This section is reproduced (with minor amendment) in the present s. 459 of the Companies Act 1985 .

58. I take "*prejudicial*" in section 111 to mean "*unfairly prejudicial*". Thus the English case law is of assistance in construing the meaning of "*oppressive or prejudicial*": it would be surprising if the legislature had intended that the fair but prejudicial conduct of a company could found a section 111 claim. Lord Hoffmann considered the meaning of "*unfairly prejudicial*" in Re Saul D Harrison & Sons plc and more recently in the House of Lords in O'Neill v Phillips [1999] WLR 1092 at 1098 D to 1099 F:

> In section 459 Parliament has chosen fairness as the criterion by which the court must decide whether it has jurisdiction to grant relief. It is clear from the legislative history (which I discussed in In re Saul D. Harrison & Sons Plc. [1995] 1 B.C.L.C. 14, 17–20) that it chose this concept to free the court from technical considerations of legal right and to confer a wide power to do what appeared just and equitable. But this does not mean that the court can do whatever the individual judge happens to think fair. The concept of fairness must be applied judicially and the content which it is given by the courts must be based upon rational principles. As Warner J. said in In re J.E. Cade & Son Ltd. [1992] B.C.L.C. 213, 227: "The court … has a very wide discretion, but it does not sit under a palm tree"
>
> Although fairness is a notion which can be applied to all kinds of activities its content will depend upon the context in which it is being used. Conduct which is perfectly fair between competing businessmen may not be fair between members of a family. In some sports it may require, at best, observance of the rules, in others ("it's not cricket") it may be unfair in some circumstances to take advantage of them. All is said to be fair in love and war. So the context and background are very important.
>
> In the case of section 459, the background has the following two features. First, a company is an association of persons for an economic purpose, usually entered into with legal advice and some degree of formality. The terms of the association are contained in the articles of association and sometimes in collateral agreements between the shareholders. Thus the

manner in which the affairs of the company may be conducted is closely regulated by rules to which the shareholders have agreed. Secondly, company law has developed seamlessly from the law of partnership, which was treated by equity, like the Roman societas, as a contract of good faith. One of the traditional roles of equity, as a separate jurisdiction, was to restrain the exercise of strict legal rights in certain relationships in which it considered that this would be contrary to good faith. These principles have, with appropriate modification, been carries over into company law.

The first of these two features leads to the conclusion that a member of a company will not ordinarily be entitled to complain of unfairness unless there has been some breach of the terms on which he agreed that the affairs of the company should be conducted. But the second leads to the conclusion that there will be cases in which equitable considerations make it unfair for those conducting the affairs of the company to rely upon their strict legal powers. Thus unfairness may consist in a breach of the rules or in using the rules in a manner which equity would regard as contrary to good faith.

This approach to the concept of unfairness in section 459 runs parallel to that which your Lordships' House, in In re Westbourne Galleries Ltd. [1973] A.C. 360, adopted in giving content to the concept of "just and equitable" as a ground for winding up. After referring to cases on the equitable jurisdiction to require partners to exercise their powers in good faith, Lord Wilberforce said, at p. 379:

> "The words ['just and equitable'] are a recognition of the fact that a limited company is more than a mere legal 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 [the company] 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."
>
> I would apply the same reasoning to the concept of unfairness in section 459.

59. In In re Westbourne Galleries at 379 E - G, Lord Wilberforce went on to consider the circumstances in which the court would subject the exercise of legal rights to equitable considerations:

> It would be impossible, and wholly undesirable, to define the circumstances in which these considerations may arise. Certainly the fact that a company is a small one, or a private company, is not enough. There are very many of these where the association is a purely commercial one, of which it can safely be said that the basis of association is adequately and exhaustively laid down in the articles. The superimposition of equitable considerations requires something more, which typically may include one, or probably more, of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence - this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some (for there may be "sleeping" members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members' interest in the company - so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.

60. Small private companies in which the the exercise of legal rights is subject to equitable considerations are sometimes referred to as quasi-partnerships, although at 379 G of In re Westbourne Galleries Lord Wilberforce cautioned that while to do so may be convenient it may also be confusing. Provided it is understood that a quasi-partnership company is a company and not a partnership, I find that the expression is useful shorthand.

61. However it does not follow that "*once a quasi-partnership company, always a quasi-partnership company*". As a company expands, the extent to which the exercise of legal rights is subject to equitable considerations may diminish or be extinguished altogether, eg if shares are issued to new members, without strong personal ties to the original members, who are motivated largely by hope of commercial gain. This would happen if a company were floated on the stockmarket, but might also happen in less dramatic circumstances.

62. In argument in Stack v Dowden [2007] 2 AC 432 Lord Hoffmann coined the term "*ambulatory constructive trust*" to refer to a constructive trust where the parties' common intention changed over time. By parity of reasoning, the term "*ambulatory quasi-partnership*" might be applied to a quasi-partnership where the interplay of legal rights and equitable considerations governing the relationship of the company to its members changes over time.

63. The inquiry into whether a quasi-partnership exists is fact specific. Eg in Third v North East Ice & Cold Storage Co Ltd [1998] BCC 242 at 246 C – D the Court of Session (Inner House) held that in the circumstances of that case the acceptance of new service contracts by the petitioners had discontinued any personal relationship amounting to quasi-partnership. But the Court accepted that there might be circumstances in which it could be said that a quasi-partnership continued, notwithstanding a change such as that brought about by the acceptance of the service contracts by the petitioners. Eg if there was an undertaking or agreement to that effect.

Grounds on which relief is sought

64. The First Petitioner claims relief on the following grounds.

    (1) The arrangements set out in the letters dated 10th May 2001 and 14th October 2005, and approved by the directors, were designed by the Second and Third Respondents to dilute the First Petitioner's

shareholding so that they could gain a majority interest in the Company.

(2) The Second and Third Respondents misused their control of the Company to remove the First Petitioner as an employee and director.

(3) The Company failed for a number of years, despite the First Petitioner's objections, to present audited accounts.

(4) The Company, having terminated the First Petitioner's employment, has failed to pay him his deferred salary.

65. I shall consider each ground in turn. I do not propose to deal with each and every point raised by the parties but merely with the main ones.

The arrangements set out in the letters dated 10th May 2001 and 14th October 2005, and approved by the Board, were designed by the Second and Third Respondents to dilute the First Petitioner's shareholding so that they could gain a majority interest in the Company

66. What is at issue here is the purpose of these arrangements. The Second and Third Respondents reject the First Petitioner's allegations and assert that the purpose of the arrangements was to provide the Third Respondent with some measure of security for the extensive sums that she had loaned to the Company. By "security" I mean that the unsecured loan was to be converted into equity, with the Third Petitioner having the option to compel the Company to buy back the shares at a premium after three years. The dilution of the First Petitioner's shareholding (as of the Second Respondent's shareholding) was on their evidence simply an ancillary consequence of this arrangement. Moreover, it was not sufficient to give the Second and Third Respondents a combined majority of common shares.

67. Turning to the letter of 10th May 2001, I find that this was no more than "an agreement to agree". It was not itself a "*convertible debenture*", but set out

the terms on which any such instrument might be purchased. I understand that by "*convertible debenture*" the Second and Third Respondents meant a written acknowledgment of debt containing terms by which the debt could be converted into equity. I read the letter as providing that the conversion of the debenture to equity was at the election of the Third Respondent but required the consent of the Company. This made commercial sense for both parties. It gave the Third Respondent some measure of security and allowed the Company to continue trading.

68. The alternative reading – that the Company could compel the Third Respondent to convert her debt into shares in a company which could not afford to buy them back, and which might prove to be worth little or nothing – would not have made commercial sense to any reasonable creditor. In so concluding I bear in mind that a debenture is an instrument primarily for the benefit of the creditor not the debtor. I also bear in mind that the Third Respondent, who could have stopped providing credit to the Company, in which case it would have ceased trading, or have had it wound up as insolvent, was in the stronger bargaining position.

69. I accept that the Second Respondent signed the 10th May 2001 letter on behalf of the Company without any formal discussion with the other directors. I have insufficient evidence from which to conclude whether there was any informal discussion. However the Second Respondent was acting within the scope of his authority as CEO and could reasonably have formed the view that the arrangement in the letter was in the Company's best interest. I see nothing oppressive or prejudicial in that arrangement.

70. On 23rd February 2003 the directors passed a resolution approving the conversion of $300,000 "*of the convertible debenture due in 2006*" to the Third Respondent into equity at a rate of $1 per share. As I have explained earlier, there was not in fact any convertible debenture. But there was at least $300,000 worth of debt. As the First Petitioner approved the resolution I infer that as of 23rd February 2003 he was aware of the arrangement set out in the 10th May 2001 letter; accepted that the Company was indebted to the

Third Respondent in the sum of at least $300,000; and did not object to the conversion rate of $1 per share.

71. As to the events of October 2005, I have to decide whether the allocation of additional shares to the Third Respondent was pursuant to a fraudulent scheme. I remind myself that although the standard of proof in civil proceedings is always on a balance of probabilities, the more serious the allegation the greater its inherent improbability, and hence the greater the cogency of the evidence required to prove it. See Jugnauth v Ringadoo [2008] PC 50 at paras 16 – 19, and the decisions of the House of Lords therein cited.

72. I am mindful that the Third Respondent was in a sufficiently strong position to obtain, jointly with the Second Respondent, control of the Company without the need for subterfuge. Had she sued to enforce her debt the Company would have gone into liquidation. I also bear in mind the fact that the schedules that she drew up at the time, which showed how the $569,934 debt was calculated, showed too that $300,000 of that debt had already been converted into equity. I am mindful, too, of the fact that neither she nor any of the other directors were lawyers, and that they did not necessarily analyse the relevant letters and resolutions in the way that a lawyer would have done.

73. When cross-examined about the arrangement proposed in the 14th October 2005 letter, the Third Respondent said that she had wanted the debt restructured in a way that was reasonable. She said the purpose was not to dilute the First Petitioner's interest in the Company. She accepted that she took approximately half a million shares to write off approximately half a million dollars in debt. She explained the benefit to her was that if the Company was repurchased she would get back some of the earnings that she had lost. It cleaned up the balance sheet, which the Company needed to do, as the Bank was insisting on that. It delayed things for the Company by a minimum of three years. She said it was "*beyond her*" whether the fact that

she might suddenly ask for this money to be paid back to her was carried on the Company's books as a contingent liability.

74. When the Third Respondent stated in the 14th October 2005 letter that: "*The total amount of the debt is $569,934*", in my judgment what she meant was that this was the amount of money which she had loaned to the Company and for which she had received no cash repayment. She did not mean to state that this was the amount of debt over and above the $300,000 that had been converted into equity. The purpose of the arrangement set out in the letter was to provide her with security for the remaining $269,934.

75. Of course the conversion of debt into equity wiped out the debt. But the Third Respondent saw that as a temporary state of affairs. She looked on the conversion of debt into equity as a way of restructuring the debt so as to provide her with a modicum of security until such time as the Company was in a position to buy back the shares and so, in effect, repay the loan with interest. Thus, when giving evidence, she characterised the premium at which she could compel the Company to buy back the shares as representing interest on the debt.

76. The intention of the directors' resolutions of 17th October and 24th October 2005 was to give effect to the arrangement in the letter. I accept that the wording of the resolution of 24th October 2005 lends itself more readily to the interpretation put upon it by the First Petitioner, ie that the Third Respondent was to be allotted an additional 569,934 shares. But in all the circumstances, and having heard live evidence from the First Petitioner and the Second and Third Respondents, I am not satisfied that this is what was intended. I think it more probable that their intention, and that of the directors' meetings on 17th and 24th October 2005, was to arrive at a position where the $569,934 debt as shown in the schedules was converted into equity, and that this figure was intended to include the $300,000 that had already been converted.

77. The apparent omission of the alleged conspirators to have the Third Respondent registered as holder of the shares allocated to her under the arrangement contained in the 14th October 2005 letter, and the Third Respondent's decision to take a portion of her shares as non-voting shares, sit unhappily with the allegation of fraud.

78. The First Petitioner does not dispute that as of 14th October 2005 the Company had incurred $569,934 of debt to the Third Respondent, of which $300,000 had already been converted into shares at the rate of $1 per share. However I understand his position to be that even if, as I have found, the Respondents intended to issue a further 269,934 shares to the Third Respondent at a rate of $1 per share, this was unfairly prejudicial to him. That is notwithstanding that it would not have been sufficient to give the Second and Third Respondents control of a majority of shares in the Company.

79. The First Petitioner did not suggest that the Third Respondent used her credit card for illicit purposes, and he accepted that the monies that she had loaned to the Company were instrumental in keeping it afloat. As in 2001 and 2003, the Third Respondent was in a stronger bargaining position than the Company. She was not prepared to convert debt into equity at a higher rate than $1 per share and there is no material before me from which I can properly conclude that the shares were converted at an undervalue. Indeed there is force in the suggestion of the Second and Third Respondents that the Company got a bargain.

80. The First Petitioner submits that the situation in 2005 was not comparable to the situation in 2003 because in 2003, unlike 2005, the Company's Bank was pressing the Company to reduce the level of debt shown on its balance sheet. The Third Respondent disputed this. In any event, the requirement that the Company provide her with some security for the loan monies was a constant in both situations.

81. The First Petitioner further submits that, if the Company felt compelled to convert the Third Respondent's debt into equity, it should have required her to accept the conversion rate of $2.45 per share as set out in the 10th May 2001 letter. But, as I have explained, the letter did not empower the Company to compel the Third Respondent to convert her shares at that or any other rate. Neither did it operate so as to preclude the Company from agreeing other terms for the conversion of debt into equity.

82. Nor, contrary to the submissions of the First Petitioner, did the 10th May 2001 letter constitute an agreement that the Company's indebtedness would not fall due until 10 May 2006, ie until five years after the date of the letter. The letter contemplated that if the Third Respondent purchased a "*convertible debenture*", then the debt secured by that instrument would not become payable until that date. If she did not purchase a "*convertible debenture*" then, as the terms of the loans did not provide otherwise, they would have been repayable on demand.

83. The Third Respondent was no longer prepared to convert her debt into shares at a rate of $2.45 per share. Had the Company insisted on conversion at that rate or not at all, she would no doubt have ceased funding the Company, with the result that it would have had to cease trading. Had she called for the loans to be repaid at the date of the Board meeting, as she was entitled to do, the Company would have been unable to pay and would therefore have been liable to be wound up on the grounds that it was insolvent.

84. The conditions set out in the 14th October 2005 letter that would have allowed the Third Respondent to redeem the shares within three years were not unreasonable: in order to protect her investment she wished to remain involved in running the Company and ensure that the CEO in whom she had confidence remained in place.

85. The First Petitioner also complains that the Third Respondent had not accounted for interest on the debt. If true, this would not be a good reason

for not converting the principal sum into equity. I understand, though, that the complaint relates rather to the redemption price of $1.50. The First Petitioner complains that the premium of $0.50 allowed for interest is too high.

86. I accept that the premium is a "broad brush" figure rather than a precise calculation. As the debt grew over seven and a half years until it reached $569,934 the rate of interest which the premium represents is higher than the 6% or 7% put forward by the Third Respondent, as those figures assume that the debt remained at that level throughout that period. But, as the life of the debt was greater than three years, the rate of interest is lower than the 50% over three years for which the First Petitioner contends, which would equate to an annual rate of 16.66%.

87. Even that figure would not be unreasonable in the circumstances of this case. It would be comparable to the rate of interest charged on a credit card, which would be apt given that the debt incurred by the Company to the Third Respondent arose largely through use of her credit card. Indeed her evidence was that she was paying 29% interest on her credit card. I am therefore satisfied that the premium of $0.50 was not unfairly prejudicial to the shareholders. In the event the Company has not been in a position to redeem the shares, whether at $1.50 per share or $1.00 per share.

88. In the circumstances, there was a proper commercial rationale for the deal. I am satisfied that its dominant purpose was to provide security for the Third Respondent and not to dilute the shares of the First Petitioner or any of the other shareholders. When given an opportunity at the meeting to provide a constructive alternative, neither Petitioner was able to do so.

The Second and Third Respondents misused their control of the Company to remove the First Petitioner as an employee and director

89. The First Petitioner was dismissed "*for reasons other than cause*". Dismissal for no cause is provided for in the employee handbook, the

provisions of which formed part of his contract of employment. This reflects the position at common law. Although concerns about various aspects of his conduct had been raised by the Third Respondent in her letter of 17th July 2005, and the Second Respondent in his report to the Company tabled at the directors' meetings on 17th and 24th October 2005, I have no evidence that they were ever raised with the First Petitioner and they were not put forward as reasons for his dismissal. I find that he was most likely dismissed because his relationship with the Second and Third Respondents had broken down beyond repair. Although as he was dismissed without cause, the reason for his dismissal is not material.

90. The First Petitioner has previously brought an action in this Court claiming damages for wrongful termination of his employment and in lieu of reasonable notice. Those claims were dismissed by Kawaley J (as he then was) in Thomas v Fort Knox Bermuda Ltd [2010] Bda LR 65. He now claims that his dismissal was unfairly prejudicial to him as a shareholder. This is on the basis that this was a quasi-partnership company from which the shareholders received their benefit in terms of salary rather than dividends.

91. I agree that this was a quasi-partnership company, but find that it was an ambulatory one in that the extent to which the exercise of legal rights by the Company was subject to equitable considerations varied over time as the Company developed. In particular, the issue in February 2002 of written terms and conditions of employment to the First Petitioner, which he accepted, put his employment on a purely contractual footing. In my judgment, therefore, his dismissal was not capable of being oppressive or prejudicial within the meaning of section 111.

92. After the October directors' meetings the relationship between the First Petitioner on the one hand and the Second and Third Respondents on the other was irreparably damaged to the point where, I am satisfied, they were no longer able to work together. In those circumstances the directors' decision to dismiss the First Petitioner as a Vice President, although

arguably petty, and the shareholders' subsequent decision not to reappoint him as a director, were in my judgment neither oppressive nor prejudicial.

The Company failed for a number of years, despite the First Petitioner's objections, to present audited accounts

93. Section 84 of the 1981 Act, read in conjunction with section 88 of the 1981 Act, provides that, unless all the directors and members agree otherwise, the directors of every company shall periodically lay before the company in general meeting audited financial statements for the company.

94. The members and directors of the Company agreed to waive this requirement for the financial periods ending 28th February 2002 and 28th February 2003, and the members had previously agreed to waive the requirement for the financial period ending 28th February 2001.

95. In subsequent years annual financial statements were presented at each general meeting but were not accompanied by the opinion of an auditor until the statements for the financial period ending 29th February 2012. Hence there were no audited accounts for a period of almost ten years. The Second Respondent gave evidence that during this period the Company had approached various potential auditors, but for one reason or another no audit by an appropriately qualified auditor was completed until the end of that ten year period.

96. The key reason was that the Company could not afford to have its accounts audited. Eg at the annual general meeting of the Company on 12th August 2009 the Company's financial statements for 2007, 2008 and 2009 were tabled. After discussion it was resolved to have the books audited "*as soon as it was financially feasible*". The First Petitioner voted against the resolution, stating that the audit should be conducted immediately. It was further resolved unanimously to approach the shareholders to determine whether any of them would be willing to advance funds to the Company to pay for an immediate audit. However no funds were forthcoming.

97. As the Second and Third Respondents rightly point out, this was not a case where the shareholders were deprived of information. They were provided with management accounts. The First Petitioner's counsel, however, submits that on the face of those accounts the Company embarked upon "*a series of high and questionable expenses*" which were "*doubtless*" undertaken in order to avoid having to pay any dividend or deferred salary.

98. I find the logic of this submission difficult to understand. The Company was funded throughout by the Third Respondent. It is implausible that she would permit the Company to borrow money which was then dissipated on a series of unnecessary expenses in order to avoid paying dividends or deferred salary. If the Third Respondent did not wish the Company to pay dividends or deferred salary, then, rather than engage in subterfuge to avoid those payments, she could simply have chosen not to lend it the money that was allegedly dissipated in the first place. Moreover, as noted above, the First Petitioner accepted in oral evidence that he had never suggested that the Third Respondent's credit card had been used for illicit purposes.

99. I am therefore not satisfied that the unaudited accounts do not accurately represent the Company's expenditure, nor that such expenditure was improperly incurred. There is in the circumstances no evidence from which I can properly conclude that the Company's failure to present audited accounts was oppressive or unfair.

The Company, having terminated the First Petitioner's employment, has failed to pay him his deferred salary

100. This ground was not pleaded. But as the First Petitioner dealt with it at the hearing – at some length – I shall address it briefly. His counsel referred me to the following passages in the above-mentioned judgment of Kawaley J in Thomas v Fort Knox Bermuda Ltd:

> 38. A term may, in essence, only be implied if it can clearly be inferred from the express terms of the contract to have formed part of the original

agreement. In my judgment it is only obvious that the deferred salary agreement was entered into both (a) as an incident of the key employees' status as investors and shareholders in the Company, and (b) because the Company was not as a start-up able to adequately compensate its employee/investors in cash. Inherent in the agreement was the hope that the company would prosper but the awareness that it might not. The Plaintiff was primarily an investor, not an ordinary employee. Moreover, the express terms of the various deferred compensation agreements make it clear that the Company retained the discretion as to whether or not to award cash or shares at the end of each compensation period.

39. The express terms of the contract, moreover, make no reference to the scenario where an employee entitled to deferred compensation ceases to be an employee. The deferred compensation aspect of the Plaintiff's contract of employment expressly referenced the fact that the Plaintiff was a substantial shareholder of the Company. Accordingly, the package was agreed in a factual matrix within which the parties knew or must be deemed to have known that even if the Plaintiff left the employ of the Company, he would retain the option to monitor the Company's financial status and ability to pay the deferred compensation through the pursuit of shareholder remedies.

40. In these circumstances, there is no credible basis for the implication of the term contended for by the Plaintiff. In my experience this sort of contractual term (providing for the crystallization of deferred compensation rights upon termination of employment) is ordinarily dealt with through express agreements, not left to implication. I find that the only term which can be fairly implied to give efficacy to the Plaintiff's employment contract is that on termination of employment, the key employees such as the Plaintiff are entitled to be paid as soon as reasonably practicable subject only to the ability of the Company to make such payments in the form of cash and/or equity.

41. The Plaintiff's case in the present action was directed towards demonstrating that the amounts admittedly due were presently due in cash by virtue of his termination. The rejection of this claim (accepting the Company's contentions that a contingent or prospective claim does exist) leaves open for future determination, whether in the pending section 111 of the Companies Act 1981 proceeding or otherwise, the general question

> of whether and when the Company is able to actually pay the deferred compensation either by issuing shares or as a money debt which is presently due and owing. Until then, it remains a contingent obligation.

101. I agree with Kawaley J that the First Petitioner, like the other shareholder employees whose salary payments have been deferred, is entitled to be paid his deferred salary once the Company is in a position to do so. However the Company is not presently in that position. The continuing deferral of the First Petitioner's salary – and in this respect he is in the same position as the other shareholder employees – therefore involves no unfairness or oppression.

Rectification of the Company's register of members

102. Section 67(3) of the 1981 Act is headed "*Power of Court to rectify register*". It provides that, on an application under the section, the Court "*generally may decide any question necessary or expedient to be decided for rectification of the register*". I am invited by both the First Petitioner and the Respondents to deal with rectification.

103. Accordingly, I direct that the Company's register of members be rectified to show that 269,934 shares were allocated to the Third Respondent on 24th October 2005. Together with the 300,000 shares allocated to her previously, these shares represent the conversion of $569,934 debt into equity. It is necessary to rectify the register because it is not clear from the Company's existing records whether the Third Respondent was ever registered as the holder of those 269,934 shares.

104. If, as was the case at the hearing date, the Company's register of members does not show the following allotments which, I am satisfied, were approved by resolutions of the directors on 15th February 2002, I direct that it should be amended so that it does: 49,600 shares to the First Petitioner, 43,600 shares to the Second Petitioner, and 57,600 shares and a further 32,558 shares to the Third Respondent.

Offer to purchase the First Petitioner's shares

105. The Company has made an open offer to buy the First Petitioner's shares for their fair value as determined by the Court, or an independent valuer to be appointed by the Court, or by an agreement between the parties.

106. The offer is well made. Fairness requires that the Company, having dismissed the First Petitioner as an employee and decided not to reappoint him as a director, offers to purchase his shares at their fair value.

107. The First Petitioner may wish to avail himself of this offer, or alternatively to hold onto his shares in the hope that they will increase in value.

108. In the circumstances I propose to make no order with respect to the purchase of the First Petitioner's shares unless he invites me to do so.

Summary

109. The questions arising on the petition are resolved thus:

(1) The arrangements set out in the letters dated 10th May 2001 and 14th October 2005, and approved by the directors, were not designed by the Second and Third Respondents to dilute the First Petitioner's shareholding so that they could gain a majority interest in the Company. They had a proper commercial rationale in that their dominant purpose was to provide some measure of security for the Third Respondent in the sense of converting her unsecured loan to the Company into equity with the option that after three years she could compel the Company to buy back her shares at a premium representing interest on the loan.

(2) The removal of the First Petitioner as an employee and director was not oppressive or prejudicial. By the date of his dismissal as an employee, his terms and conditions of employment were no longer subject to equitable considerations but were purely contractual. The

Company was within its rights to dismiss him without cause. His appointment as a director was not renewed as his relationship with the Second and Third Respondents was damaged beyond repair. There was in my judgment nothing untoward in that.

(3) The Company's failure for a number of years to present audited accounts, which I am satisfied was due chiefly to lack of funds, was not oppressive or prejudicial to the First Petitioner. He had access to the unaudited accounts. I am not satisfied that they do not accurately reflect the Company's expenditure nor that such expenditure was improperly incurred.

(4) The Company's continuing failure to pay the First Petitioner his deferred salary is not oppressive or prejudicial to him as the Company is not, and has not been at any material time, in a position to pay deferred salary to him or any of the other shareholder employees.

110. Subject to any directions that the First Petitioner may invite me to give regarding the purchase of his shares by the Company, the petition is therefore dismissed.

111. I shall hear the parties as to costs.

DATED this 26th day of February, 2014

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Hellman J