Finance, Property and Business Litigation in a Changing World

25-26 April 2013
Supreme Court Auditorium

Organisers:

Finance, Property and Business Litigation in a Changing World

Plenary Session 3
Company, Shareholder and Joint Venture Disputes

Chairperson

The Honourable Justice Quentin Loh,
Supreme Court of Singapore

Speakers

Professor Walter Woon SC, *Faculty of Law, National University of Singapore*

Mr Malcolm Davis-White QC, *4 Stone Buildings*

Mr Michael Todd QC, *Erskine Chambers*

FINANCE, PROPERTY AND BUSINESS LITIGATION IN A CHANGING WORLD

25 & 26 April 2013 Supreme Court Singapore

A JOINT CONFERENCE OF THE SINGAPORE ACADEMY OF LAW AND THE CHANCERY BAR OF ENGLAND AND WALES

Company, Shareholder and Joint Venture Disputes

The Legal Framework

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Where rights and obligations are to be found

- Contract: Constitutional Documents
  - Partnership Deed
  - Articles of Association
- Contract: Joint Venture Agreement

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Where rights and obligations are to be found

- Statute
- Common Law
- Equity

Mr Michael Todd QC, Erskine Chambers

By Mr Michael Todd QC
Erskine Chambers
Finance, Property and Business Litigation in a Changing World
Plenary Session 3: Company, Shareholder and Joint Venture Disputes

Contract: Constitutional Documents

- Articles of Association
  - company's main constitutional document is its Articles of Association (s.17&18 CA 2006);
  - provisions of existing company's Memorandum of Association now treated as provisions of its Articles of Association (s.28 CA 2006).

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Contract: Constitutional Documents

- provisions of the company's constitution bind the company and its members to the same extent as if they were covenants on the part of each member to observe those provisions.

  (s.33 CA 2006; Singapore (s.39(1) CA, cap 50).

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Contract: Constitutional Documents

- provision may be made in Articles of Association enabling a member to nominate another person as being entitled to enjoy or exercise all or specified rights of the member in relation to the company.

(s.145(1) CA 2006)

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Contract: Constitutional Documents

- the right to require directors to call a general meeting (s.303);
- the right to notice of general meetings (s.310);
- to speak at meetings (s.319A);
- to appoint proxies to act at meetings (s.324); and
- the right to be sent copies of the company's annual accounts and reports (s.145(3)).

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Contract: Joint Venture Agreement

- Conflict between JVA and Constitutional Documents
  - Salomon v A. Salomon & Co Ltd [1897] AC 22
  - Re Duomatic Ltd [1969] 2 Ch 365
  - Russell v Northern Bank Development Corporation Ltd [1992] 1 WLR 588
  - Welton v Saffery [1897] AC 299
  - British America Nickel Corpn v M J O'Brien Ltd [1927] AC 269

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Contract: Joint Venture Agreement

- Implied Terms: Attorney General of Belize v Belize Telecom Ltd [2009] 1 WLR 1988
  - An unexpressed term will only be implied if it is clear that the parties must have intended that term to form part of their contract. It is not sufficient that the parties, as reasonable men, would have agreed to it if it had been suggested to them: Trollope & Colls Ltd v North West Regional Hospital Board [1973] 1 WLR 601

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Contract: Joint Venture Agreement

- Implied Terms:
  - the process of implication is now synonymous with the process of interpretation of contracts: Stena Line Ltd v Merchant Navy Ratings Pension Fund Trustees Ltd [2011] EWCA Civ 543; Lewinson, The Interpretation of Contracts 5th edn.
  - Interpretation of contracts: Rainy Sky SA v Kookmin Bank [2011] UKSC 50.

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Statute/Common Law

- In England & Wales directors' duties now codified (ss.170 to 177):
  - Duty to act within powers (s.171);
  - Duty to promote the success of the Company (s.172);
  - Duty to exercise independent judgment (s.173);
  - Duty to exercise reasonable care, skill and diligence (s.174);
  - Duty to avoid conflicts of interest (s.175);
  - Duty not to accept benefits from third parties (s.176);
  - Duty to declare interest in proposed transaction or arrangement (s.177).

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Statute/Common Law

- Duties are owed by the director of a company to the company (s.170(1))
- Duties not owed to the person who appointed or nominated the director: Scottish Co-operative Wholesale Society v Meyer [1959] AC 324; Re Neath Rugby Ltd (No 2), Hawkes v Cuddy [2009] 2 BCLC 427.

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Equity

"The directors indeed stand in a fiduciary relationship to the company, as they are appointed to manage the affairs of the company and they owe fiduciary duties to the company though not to the creditors, present or future, or to individual shareholders."

Multinational Gas and Petrochemical Co Ltd v. Multinational Gas and Petrochemical Services Ltd [1983] Ch 258.

- Exceptionally fiduciary obligations to shareholders may be assumed by directors or imposed on them by law

  Coleman v Myers [1977] 2 NZLR 225.

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Equity

- In Joint Ventures, in the absence of express provisions, generally fiduciary obligations will not be implied.
  - UK
    - Ebrahimi v Westbourne Galleries Ltd [1973] AC 360,
    - Coroin Limited; McKillen v Misland (Cyprus) Investments Ltd [2012] EWHC 521
    - O'Neill v. Phillips [1999] 1 WLR 1092.

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Equity

- Australia
  - United Dominions Corporation Ltd v Brian Pty Ltd (1985) 157 CLR 1.
  - Keith Henry & Co Pty Ltd v Stuart Walker & Co Pty Ltd (1958) 100 CLR 342 Dixon CJ High Court of Australia:
- Hong Kong
  - Alan Hoo v Benjamin Lung [2005] HKEC 2043;
  - Kao Lee & Yip v Koo Hoi Yan [2003] 3 HKLRD 296.
  - Hong Da Development & Investment Holding Co Ltd v China Aoyuan Property Group Ltd [2011] HKEC 1664

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Equity

- Malaysia
  - Hartela Contractors Ltd v Hartecon JV Sdn Bhd [1999] 2 MLJ 481 CA Gopal Sri Ram 497.
  - Newacres Sdn Bhd v Sri Alam Sdn Bhd [1991] 3 MLJ 474.

Touchstone for these relationships: Mason J in Hospital Products Ltd v United States Surgical Corporation (1984) 156 CLR 41

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Hospital Products

"The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship … is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position … It is partly because the fiduciary's exercise of the power or discretion can adversely affect the interests of the person to whom the duty is owed and because the latter is at the mercy of the former that the fiduciary comes under a duty to exercise his power or discretion in the interests of the person to whom it is owed."

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Nominee directors: some pitfalls

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The joint venture company

- Ownership/equity interest
- Management interest and/or oversight
- Joint venture documents

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The nominated and the nominee director

Nominee directors:

> "in the performance of their office, act in accordance with some understanding, arrangement, or status which gives rise to an obligation (in the wide sense) to their appointor"

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Appointment and removal

- Right attached to shares, usually as a class and/or
- Right to appoint/remove by virtue of shareholders' agreement

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One "package" of documents

Jackson v Dear

- [2012] EWHC 2060 (Ch) (Briggs J)
- [2013] EWCA Civ 89 (Court of Appeal)

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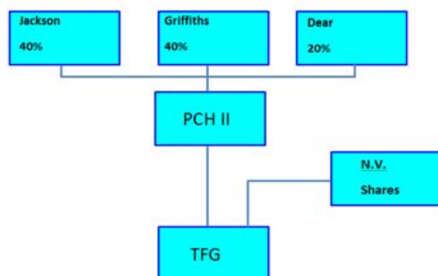

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- Shareholders agreement:
  - Holding company (PCH II) to appoint and re-appoint Jackson as director of TGF unless termination event
- Article 88(1)(f) TGF:
  - Power of directors to serve notice on director to vacate office (whether or not Termination Event)

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- Jackson removed as director by other directors of TFG.
- PCH II (through Griffiths and Dear): no point in re-appointing Jackson as director as he will be removed again.
- Jackson: renders agreement to appoint nugatory.

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The problem?

- Shareholders' agreement provided for removal as director only on Termination Events
- Constitution did not so limit the power of removal by the other directors

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- Jackson: implied term in shareholders' agreement: parties would procure that he was not removed as director (Dear & Griffiths as directors and parties to shareholder agreement bound by such term).
- Griffiths & Dear: no term to be implied. Directors' power of removal subject to fiduciary duties.

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The Courts

Principles of construction and implication of terms largely agreed as derived from:

- *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896;
- *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101;
- *Rainy Sky S.A.v Kookmin Bank* [2011] 1 WLR 2900;
- *Attorney General of Belize v Belize Telecom Ltd* [2009] 1 WLR 1988 (PC);
- *Mediterranean Salvage & Towage v Seamar Trading & Commerce Inc* [2009] 1 C.L.C. 909;
- *Groveholt Ltd v Hughes* [2010] EWCA Civ 538.

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- Briggs J: implied term to prevent shareholders agreement being rendered futile.
- Court of Appeal: no implied term. It could not be said that "any" reasonable person would say such an implication was "obvious". Reasonable people could disagree as to the objective of the agreements.

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UK codified directors duties

- Codified but (Companies Act 2006, s170)
  - Based on and take effect in place of common law rules and equitable principles;
  - To be interpreted and applied in the same way as the common law rules and equitable principles and in so doing, regard is to be had to the corresponding rules and principles

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Main duties relevant in nominee context

- to exercise powers for purposes for which conferred (s171 CA 2006);
- to promote the success of the company for the benefit of the members as a whole (s172 CA 2006);
- to exercise independent judgment (s173 CA 2006);
- to avoid conflicts of interest (s175 CA 2006).

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AND *Re Barings plc* [1999] BCLC 433 at 439

- to acquire and maintain a sufficient knowledge and understanding of the company's business
- Power to delegate but remaining duty thereafter to supervise

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Must exercise independent judgment

- *Boulting-v-Association of Cinematograph, Television and Allied Technicians* [1963] 2 QB 606 at 626 per Denning MR
- *Selangor United Estates Ltd v Cradock (no 3)* [1968] 1 WLR 1555.

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Duty to act in company's interest;Conflict of duties or of duty to company and self- interest

- the company's interest means the interest of all shareholders, not a sectional part of them:
  - *Greenhalgh v Aderne Cinemas Ltd* [1951] Ch 286
- the avoidance of conflict is of the potential for conflict not merely actual preference of self interest or other duty:
  - *Furs Ltd v Tomkies* (1936) 54 CLR 583 at 592

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Actual conflict

Scottish Co-operative Wholesale Society Ltd v Meyer [1959] AC 324

- SCWS set up subsidiary: STM (4,000 shares)
- Minority shareholders in STM: Dr Meyer and Mr Lucas (3,900)
- Directors of STM: 3 nominees of SCWS (also directors of SCWS) and Dr Meyer and Mr Lucas.

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- Attempt to buy out shares of minority and when unsuccessful…
- Diversion of business of subsidiary to new department of holding company, assisted by nominees
- Impermissible conflict arose:
  - When subsidiary board considered re-alignment of shares;
  - When parent set up competing business

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Access to books and records

Access at common law:

Why?

Wuu Khek Chaing George v ECRC Land Pte Ltd [1999] 3 SLR 65

Conway v Petronius [1978] 1 WLR 72 at 88, 90.

Fox v Gadsden Pty Ltd (2003) 46 ACSR 717

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Access to records: to what?

Not limited to financial books and records:

- Debenture trust deeds and connected documents: *Burns v London and South Wales Coal Company* [1890] W.N. 209;
- Minutes of general meetings and of directors in addition to books of account: *McCusker v M'Rae* [1966] S.C. 254.
- *Wuu Khek Chaing George v ECRC Land Pte Ltd* [1999] 3 SLR 65 at 74 para 25.
- Share register, documents relevant to issuing of shares and documents relevant to appointment of proxies to act at an EGM: *In re Jervois Mining Ltd, Campbell v Jervois* [2009] FCA 316 at paras 45 and see form of order.

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Also statutory rights

- e.g. accounting records (CA 2006, s388 (UK) and Companies Act, s199 (Singapore).
- Statute only relevant to civil enforcement if it varies the common law position:

Oxford Legal Group v Sibbasbridge [2008] EWCA Civ 387
(and see e.g. Companies Act, s199(5) (Singapore); Corporations Act 2001 s290 (Australia)).

Nominee difficulties with access rights:

- Access right exercisable only for proper purposes
- Breach of confidentiality, not in best interests of company, not in interests of shareholders as a whole if information passed to appointor?

Courts attenuate nominee duties?

- *Levin v Clark* [1962] NSWR 686
- *Berlei Hestia (NZ) Ltd v Fernyhough* [1980] 2 NZLR 150
- *Japan Abrasive Materials Ltd v Australian Fused Materials Pty Ltd* (1998) 16 ACLC 1172
- *Re Neath Rugby Ltd* [2008] BCLC 527

Legislation attenuates nominees duties?

- Companies Act 1993, s131 (New Zealand)
- Corporations Act, s187 (Australia)
- Recommendations of "Report No 8 on Nominee Directors and Alternate Directors (1989)" of the Australian Companies and Securities Law Review Committee

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Express agreement/constitutional provision?

- Express authorisation of relevant conflict positions; taking into account sectional interests; ability to act as requested by nominator
- Nominee access to information and ability to pass confidential information to appointor
- No liability in appointor in respect of receipt of information
- Future investment in joint venture and who is to enforce
- Dilutions of interest of JV parties
- Business competition

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Nominee directors: some pitfalls

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The Joint Venture Company

1. The company is a typical form of vehicle used for joint ventures. That is because it carries a number of benefits: typically separate personality, limited liability, divorce of management from ownership and great flexibility. There may also be taxation advantages.

2. In any joint venture the joint venturer will wish to have an ownership, or equity, interest in the venture and also to have, to a greater or lesser extent, an involvement in the management of the venture.

3. In the case of companies the ownership interest will typically be represented by way of shareholding. However, a joint venturer's equity interest may be represented by something which is technically a debt interest. The flexibility of company law is such that a shareholding interest may, in economic terms, become such an attenuated ownership interest that it will be more like a debt interest and similarly what is in law a debt interest may be so structured that in economic reality it may be more like an equity or ownership interest.

4. There can be a further complication: a shareholding interest may be direct, by way of shareholding in the company in question, or indirect, for example, by way of shareholding in the holding company of the company in question.

5. Involvement in management will typically be by way of a right to appoint to the board of the relevant company one or more directors. That right to appoint may be pursuant to a right attached to shares or a contractual right in a joint venture or shareholders' agreement. Once appointed, a nominee director, as any other director, will owe the usual duties to his company. The fact however that he may owe duties, express or implied, to his appointor can however place him in a position of some difficulty and may also raise questions as to whether the appointor may incur liabilities through its nominee.

6. One commentator has remarked:[1]

"The director who is a nominee of a substantial shareholder is between the devil and the deep blue sea. Happily perhaps for his peace of mind he is most often unaware of the company law principles. No doubt he will remain a director while he furthers the wishes of the shareholder by whom he was appointed".

7. This paper considers two of the problems that can arise in the context of joint ventures and nominee directorships. They are first, the structuring of the rights to appoint and retain a director and secondly, the duties that such a director may owe. In the time available it is not possible to be comprehensive either in terms of subject matter[2] or in the degree of detail. However, what the analysis does show is the need for joint venturers to

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[1] Professor Parsons in "The Directors Duty of Good Faith", 5 MULR 395.

[2] For example, I do not deal with the interesting questions of (a) whether and in what circumstances the appointor may find itself liable for the actions or omissions of the nominee and (b) what information that the nominee may know or be entitled to obtain will be attributed to the appointor. This issue can give rise to real difficulties in the context of a takeover offer by the appointor governed by relevant takeover code rules requiring disclosure by the bidder.

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recognise that the purpose of complicated legal agreements is to deal with and protect their position when agreements, trust and understanding break down and for that reason time and money invested in them will be time and money well spent.

"Nominee" or "nominated" director

8. The first point to note is that there is a distinction between a nominee director and a director who is simply nominated. In the latter case, the nominator will effectively appoint the director, but thereafter there is no duty owed by the director to the nominator nor any expectation of special treatment being given by him to the nominator or its position.

9. On the other hand, nominee directors might best be described as persons: "*who, in the performance of their office, act in accordance with some understanding, arrangement or status which creates an obligation or mutual expectation of loyalty (in the wide sense) to their appointor.*"[3]

Appointment and removal of nominee directors

10. In the joint venture context, the right to appoint (and remove) one or more nominee directors is usually structured in one of two main ways. Sometimes the right to appoint is attached to particular shares, usually to shares of a particular class so that the right is entrenched as a class right. The alternative mechanism is to confer the right by way of shareholders' agreement. Sometimes both methods may be adopted.

11. Usually, the right to appoint and maintain the appointment of a nominee director raises few difficulties but in creating the right it is necessary to consider carefully the overall legal position. The dangers of not dealing with

[3] Adapted from the definition of the (Australian) Companies and Securities Law Review Committee as used in their Report no 8. It has been suggested that the Committee's definition is too wide as encompassing duties owed to persons other than the appointor (see R P Austin: "Representatives and Fiduciary Responsibilities- Notes on Nominee Directorships and Life Arrangements" Bond Law Review Vol 7, Iss 1, Article 4).

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the position carefully enough is demonstrated by, a recent case in England.[4] In that case the Courts had to grapple with the issue of how to deal with the interface between the articles of association and a shareholders' agreement regarding, in effect, the right of one joint venture party to be appointed and remain a director. The case of course turns on its own facts but there are some very interesting points of principle and approach which arise from the case. More importantly, it highlights the needs for lawyers to be extremely careful in drafting agreements and to consider the whole legal framework of a joint venture arrangement: the general law governing the company; the specific constitutional documents which are applicable and any shareholders' agreements.

12. In broad terms, in the Jackson case there had been a joint venture between the claimant, Mr Jackson and the two of the defendants, Mr Dear and Mr Griffith. The joint venture in question was conducted through various companies of the Polygon Group. For present purposes the relevant holding company was PCH II, a company incorporated in the Cayman Islands. The shares in PCH II were held as to 40% by Mr Jackson, 40% by Mr Griffith and 20% by Mr Dear.

13. PCH II in turn held all the voting shares in a Guernsey company, TFG. All the issued non-voting shares in TFG were held by members of the public. The articles of TFG provided for, among other things, the majority of the board to be comprised of independent directors. However, the quorum and voting provisions were such that while the independent directors could veto resolutions affecting the management of the affairs of the company they could not insist upon them.

14. The articles also provided that the voting shareholders had an unfettered right to appoint and remove directors and that a director would cease to be a

[4] *Jackson v Dear* [2012] EWHC 2060 (Ch) (Briggs J); [2013] EWCA Civ 89 (Court of Appeal)

director in a number of specified circumstances such as on resignation, becoming bankrupt, or becoming of unsound mind. One of those circumstances, under article 88(e), was if he was given notice by all other directors to vacate office.

15. Following a dispute between the three individuals, their interests were re-organised and, at the date of the relevant shareholders' agreement, they were as described above. The articles of association of TFG were not changed in any material way at that time. A shareholders' agreement was entered into. That agreement, among other things, made provision that the voting shares of PCH II (which was a party to the agreement, as were the three individuals) in TFG would be used to appoint Mr Jackson as director of TTG and at each AGM to re-appoint him as director. However, this was only unless and until there was a Termination Event (as defined). One such event was if Mr Jackson breached his fiduciary duties.

16. In January 2011, notice to vacate office as director of TFG was served on Mr Jackson, by the other directors of TFG. In December 2011, at the AGM of TFG, Mr Griffith and Mr Dear caused PCH II to decline to re-appoint Mr Jackson as a director, on the basis that to do so would be futile. Once he was re-appointed, the board of TFG would simply remove him. In fact it was alleged that Mr Jackson was in breach of his fiduciary duties in any event. Court proceedings followed. To avoid the delay of litigating the breach of fiduciary duty case, Mr Griffith and Mr Dear proceeded on the basis that their position was justified as a matter of construction of the relevant agreement and constitution and that the case could be resolved on that basis.

17. At the most basic level the problem arose because the shareholders' agreement dealt with and regulated what the shareholder, PCH II, could and should do but did not in terms deal with the limits and restrictions on the powers of the directors of TFG to remove directors.

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18. The issues before the Court were two-fold:

18.1. First, should terms be implied into the shareholders' agreement that, provided no termination event had occurred, Mr Jackson would not be removed as a director and that the parties to the shareholders' agreement would procure that he should not be removed as director?

18.2. Secondly, whether a clause for further assurance, that is for the taking such further actions as might reasonably be required to give effect to the shareholders' agreement, required the parties to prevent his removal under article 88(e) of TFG's articles.

19. Put in a nutshell:

19.1. Mr Jackson's case was that article 88(e) risked rendering futile a primary obligation of the parties to the agreement, namely to appoint him as a director.

19.2. The defendants said that article 88(e) was an important safeguard for the proper administration of the company and that given the absence of express provision there was no room to imply any term limiting its effect.

20. Mr Justice Briggs at first instance decided that terms were to be implied into the shareholders' agreement limiting the right of removal of Mr Jackson as shareholder. The Court of Appeal disagreed.

21. The problem that had arisen was that while at voting shareholder level the removal of Mr Jackson as director had been limited to Termination Events,[5] his removal at director level, by the directors, was at large and not expressly limited by the shareholders' agreement.

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[5] Although not spelled out, Briggs J agreed that a term was obviously to be implied not to use the voting rights of PCH II to remove Mr Jackson as director of TFG between AGMs, unless a Termination Event had taken place (see para [46]).

22. The case contains a useful summary of the recent English authorities regarding construction of contracts and the implication of terms. Citation of these authorities seems to have taken up a great deal of the two days before Briggs J. The main ones considered were: *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101, *Rainy Sky S.A.v Kookmin Bank* [2011] 1 WLR 2900, *Attorney General of Belize v Belize Telecom Ltd* [2009] 1 WLR 1988 (PC); *Mediterranean Salvage & Towage v Seamar Trading & Commerce Inc* [2009] 1 C.L.C. 909, and *Groveholt Ltd v Hughes* [2010] EWCA Civ 538. I set out the general propositions derived by the parties from these cases in the Annex to this paper.

23. The main arguments were as follows. Mr Griffith and Mr Dear, among other things, said that:

    23.1. the shareholders' agreement dealt solely with and regulated solely the exercise of shareholders' voting rights;

    23.2. it had been carefully negotiated in detail, by lawyers, after disputes had arisen;

    23.3. at the time, the articles had been left as they were;

    23.4. there was a good reason for the provisions of article 88(e). It enabled the directors (for example) to remove Mr Jackson as director if they could not get on with him.

    23.5. however, the directors did not have an unfettered power to remove Mr Jackson under article 88(e). That power would have to be exercised properly in accordance with their fiduciary duties.

    23.6. further, the fact that there were independent directors of the board was an important consideration, it was a further safeguard for Mr Jackson when considering the operation of article 88(e);

    23.7. finally, not only might the directors properly act within their fiduciary duties in operating article 88(e), their fiduciary duties might compel them to do so.

24. Mr Jackson, with whom Briggs J agreed, was that article 88(e) could render the Shareholder Agreement provisions futile. Mr Griffiths and Mr Dear could side-step them by inviting the independent directors to concur in exercising the power of removal under article 88(e). The effect would be that parties to the agreement would be able to render it futile by their own voluntary actions. As regards the argument that the directors might be in breach of fiduciary duty in <u>not</u> removing Mr Jackson under article 88(e), that could be dealt with in one or more of three ways: (1) by a resolution of PCH II as shareholder (as provided for by article 83) directing the directors not to invoke article 88(e) unless a Termination Event had occurred; (2) by using PCM II's voting power to pass a relevant exonerating resolution under the *Duomatic* principle[6] (subject to TFG being solvent); and (3) to procure that PCH amended the articles of TFG, by disabling its operation against Mr Jackson unless there was a Termination Event.

25. The Court of Appeal viewed the matter differently and essentially agreed with Mr Jackson. Among other matters:

25.1. they did not consider that "any" reasonable person would agree that the terms which it was said should be implied, were "obvious": reasonable people could disagree whether the Agreement's objective was as contended for by Mr Jackson or by Mr Griffith and Mr Dear;

25.2. the involvement of lawyers in the drafting of the agreement to settle an extant dispute told heavily against implying further terms;

25.3. the relevant terms of the Agreement would not be "futile" if article 88(e) retained its ordinary effect. Mr Jackson had been re-appointed a director for some years and article 88(e) was not an unfettered power;

25.4. Independent Directors reading the articles were entitled to take them at face value: they would have no knowledge of the terms and contents of collateral matters such as shareholder agreements.

[6] Re Duomatic [1969] 2 Ch 365.

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26. It is not necessary to deal with the arguments regarding further assurance as the operation of the relevant clause depended on the answer to the main question as to whether terms should be implied.

27. The case demonstrates the very real need to consider very carefully in a joint venture context how all the documents tie together.

28. Providing for an appointment and retention of a nominee director is however only the start of the process of protecting the joint venturer's involvement in and information about management. Careful consideration has to be given to the duties that the nominee director may come under and how they are to be structured.

<u>Codification of directors' duties in the UK</u>

29. It is important to note that although directors' duties in the UK have been codified:

    30. First, the statutory codification is in terms expressed to be based on (and take effect in place of) common law rules and equitable principles;[7]

    31. Secondly, the codified duties are by statute to be interpreted and applied in the same way as the common law rules and equitable principles and in so doing, regard is to be had to the corresponding rules and principles;[8]

    32. Thirdly, in broad terms it seems unlikely that any great divergence will emerge between the UK statutory duties and the common law duties as previously existing in England and as developing in other common law jurisdictions, whose company law jurisdictions were initially based on the UK model.[9]

[7] CA 2006, s170(3).
[8] CA 2006, s170(4).
[9] Thus, although declining to consider in the case before him whether, and if so, how the statutory duties differ from established common law and equitable duties, Warren J did opine that the duty to act "*bona fide in the interests of the co*mpany" is reflected in the statutory duty to act "*in good faith in*

The Nominee Director and his duties

33. The position of the nominee director can raise issues with regard to the duties owed by him as director to his company and what in England have now been codified as:

  33.1. the duty to exercise powers for the purposes for which they have been conferred (s171 Companies Act 2006);[10]

  33.2. the duty to promote the success of the company (s172 Companies Act 20);

  33.3. the duty to exercise independent judgment (s173 Companies Act 2006);

  33.4. the duty to avoid conflicts of interest (s175 Companies Act 2006).

In any given situation one or more of these duties may be engaged.

34. In addition, it is important to bear in mind the general duties of directors regarding management. Nominee directors cannot simply sit back and only get engaged in a company's affairs when the interests of their appointor are perceived as being directly affected. Having looked at a number of authorities, including the important Australian case of *Daniels v Anderson* (1995) 16 ACSR 607, Jonathan Parker J (as he then was) summarised his conclusions on this area as follows:[11]

"*B7. In summary, the following general propositions can, in my judgment, be derived from the authorities to which I was referred in relation to the duties of directors:*

"(i) *Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of*

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*a way most likely to promote the success of the company for the benefit of its members as a w*hole" He said that "[t]*hey come to the same thing with the modern formulation giving a more readily understood definition of the scope of the duty*."

[10] Formerly encapsulated within the principle that discretions were not to be exercised for a collateral purpose, itself forming part of the wider formulation which included, and commenced with, the statement of the subjective duty to act bona fide in the interests of the company (see e.g. *Re Smith & Fawcett Limited* [1942] Ch. 304 at 306).

[11] *Re Barings (no 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433 at 489.

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the company's business to enable them properly to discharge their duties as directors.
(ii) Whilst directors are entitled (subject to the articles of association of the company) to delegate particular functions to those below them in the management chain, and to trust their competence and integrity to a reasonable extent, the exercise of the power of delegation does not absolve a director from the duty to supervise the discharge of the delegated functions.
(iii) No rule of universal application can be formulated as to the duty referred to in (ii) above. The extent of the duty, and the question whether it has been discharged, must depend on the facts of each particular case, including the director's role in the management of the company."

35. There is a further question, which is to what extent the duties owed to the company of which he is nominee may be shaped, relaxed or attenuated or even abrogated by the terms of the constitution of the company of which he is nominee or the unanimous agreement of all the shareholders of that company. I will return to that issue later.[12] In the drafting of the agreements covering the joint venture relationship it is the principle that duties owed by a director to his company may be varied or modified which is likely to be most heavily relied upon.

36. The starting proposition is that the nominee director owes his company all the duties that any director owes his company.[13]

37. As regards his appointor, the extent to which the nominee is obliged or entitled to have regard to his appointor's wishes will depend upon the terms, express or implied, of the agreement under which the nominee director is appointed.[14] As I will go onto consider, whether any such duty or entitlement

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[12] As well as the question of the limits of the equitable principles, adverted to in there4 may be statutory limitations too: e.g. in Australia, Corporations Law s214 (preventing exemption from liability); s232(5), (6) (regarding improper use of information and position).
[13] *Re Neath Rugby Football Club, Hawkes v Cuddy (No 2)* [2007] EWHC 2999 (ch); [2008] BCC 390 (Lewison J).
[14] *Re Neath Rugby Football Club, Hawkes v Cuddy* [(HH Judge Havelock-Allen QC)

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runs up against the duties he owes as director of the company of which he is nominee has to be considered separately.

38. It has been suggested by commentators that the cases are inconsistent. What one sees in the cases is perhaps not so much a statement of inconsistent principles but statements showing different attitudes to particular factual situations. Thus, one can contrast two statements.

38.1. The first is a statement of Street J (as he then was):

> "*It is entirely foreign to the purpose for which this or any other [company][15] exists to contemplate a member of the [board of directors] being representative of a particular group or particular body. Once a group has elected a member he assumes office as a member of the [board of directors] and becomes subject to the overriding and predominant duty to serve the interests of the [company] in preference, on every occasion upon which any conflict may arise, to serving the interests of the group which appointed him, With this basic proposition there can be no room for compromise*"[16]

38.2. The second is a statement of Jacobs J:

> "*To argue that a director particularly appointed for the purposes of representing the interests of a third party cannot lawfully act solely in the interests of that third party, is in my view to apply the board principle governing the fiduciary duty of directors, to a particular situation, where the breadth of the fiduciary duty has been narrowed, by agreement amongst the body of shareholders. The fiduciary duties of directors springs from the general principles, developed in courts of equity, governing the duties of all fiduciaries....and it must be borne in mind that in such situations the extent and degree of the fiduciary duty depends not on the particular relationships, but also on the particular circumstances. Among the most important of these circumstances are the terms of the instrument governing the exercise by the fiduciary of his powers and duties and the wishes, expressed directly or indirectly, by direction, request, assent or waiver, of all those to whom the fiduciary duty is owed.*"[17]

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[15] The quotation is for present purposes applied from its context to that of the company context.
[16] *Bennetts v Board of Fire Commissioners of New South Wales* (1967) 87 WN (NSW) 307.
[17] *Levin v Clark* [1962] NSWR 686.

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39. At this point is is, perhaps, helpful to consider some of the cases in more detail.

Acting or not acting as a puppet

40. The nominee cannot sit by and either do nothing or act solely as a puppet as required by his appointor. Thus in *Selangor United Rubber Estates Limited v Craddock (No 3)* [1968] 1 WLR 1555 two directors committed a breach of fiduciary duty in misapplying company funds under their control by signing a cheque drawn on the company's account at the behest of the shareholder with a controlling interest. This was part of a scheme devised by that shareholder by which the company would improperly finance his purchase of shares in breach of the financial assistance provisions then contained in s54 of the Companies Act, 1948. The directors' plea that they simply acted under the orders of the shareholder without knowledge of the wrongful nature of the transaction failed. They were liable for their failure to exercise any "*discretion or volition*" of their own. "*They were puppets which had no movement apart from the strings and those strings manipulated by* [Cradock, the nominator and shareholder with the controlling interest]". This is a clear case of a failure to exercise independent judgment. It was a case of commission. However, a total failure to act (e.g. because the appointor did not wish the director to act or because the director did not perceive that his appointor's interests were being damaged) will also be measured against the duty to exercise reasonable care, skill and diligence and the duties summarised in the *Barings* case.

41. In the context of the question of whether certain trade union rules were valid as making members who were company directors act at the behest of the Trade Union against the interests of their company, Lord Denning MR referred by analogy to the position of nominee directors. There is, he said, nothing wrong in a nominee director nominated by a large shareholder to represent its interests:

> *"so long as the director is left free to exercise his best judgment in the interests of the company he serves. But if he is put upon terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful....or if he agrees to subordinate the interests of the company to the interests of his patron, it is conduct oppressive to the other shareholders for which the patron can be brought to book: see Scottish Co-operative Wholesale Society Ltd v Meyer."*[18]

Conflicts

42. A "puppet" director is, perhaps, the easy case. However the more difficulty arises where there is, or may arise, a conflict between the duty owed by the director to the company, to act bona fide in the company's best interests and an extraneous duty to act in the interests of the appointor.

43. At this point it is perhaps important to remind oneself a little more about the detail of the relevant fiduciary duties owed by a director.

    43.1. First, as regards the duty to act bona fide to promote the success of the company or to act bona fide in the interests of the company, that duty is subjective in this sense. The relevant test is what the director bona fide considers to be in the interests of the company and not what the court considers to be in the best interests of the company. However, the interests of the company (or, as it is put in the UK duty as codified, the duty to promote the success of the company for the benefit of its members as a whole) is a duty to promote the interests of all shareholders not simply a sectional part of them (see *Greenhalgh v Aderne Cinemas Ltd* [1951] Ch 286[19]).

    43.2. Secondly, as regards the rules on conflicts, the Courts of equity apply a strict rule. The need to avoid conflict includes the potential for conflict (and not just a situation where there has been an actual preference of self interest or other duty over the duty to the company.)

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[18] *Boulting v Association of Cinematograph, Television and Allied Technicians* [1963] QB 606.
[19] Actually a case about the limits on the powers of majority shareholders in passing resolutions.

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44. Now a situation which is, perhaps, not that difficult as a matter of law is where there is an actual conflict between the duty owed to the company and the duty owed to the appointor and the nominee knowingly prefers the interests of his nominator. In *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324, the Society formed a subsidiary to manufacture rayon. It held the majority of shares and had the right to and did appoint three nominees to the board. Just under 50% of the shares in the subsidiary were held by two others who were appointed joint managing directors. The society unsuccessfully tried to buy them out at par an attempt described by Viscount Simonds as being "*to obtain a grossly unfair advantage*". When that failed, it adopted a policy of transferring the company's business to a new department within its own organisation. The nominee directors although aware of the new policy, did not inform their co-directors of it but secretly promoted the holding company's plans. They were held to have been in breach of duty. Today in English law the duties breached would probably be characterised as being the duty to exercise independent judgment, the duty to avoid conflicts and the duty to promote the success of the company.

45. In such circumstances the nominee director will have to take him or herself out of the position of conflict either by concentrating on their duty to the company to the exclusion of any duty to their appointor or by resigning or (where this is possible), by ensuring that both sets of principals have adequate care taken of their interests (*Re Cumberland Holdings Ltd* (1976) 1 ACLR 36 at 373, reversed on appeal but without disapproval of reasons of law (1977) 2 ACLR 307).

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<u>Directors access to books and records[20]</u>

46. At this point it is perhaps convenient to look at the question of directors' access to company books and records and how such rights of access apply in the context of nominee directors.

47. The right of a director at common law to have access to the company's books and records has been identified as being "*essential to the proper performance of a director's duties*" and to enable him to carry out his duties.[21]

48. In Singapore it has been said:

> "*At common law, a director has the right of inspection of any documents such as the accounting and other records of the company and such right is a concomitant of the fiduciary duties of good faith, care, skill and diligence which the director owes to the company*." (per LP Thean JA, *Wuu Khek Chaing George v ECRC Land Pte Ltd* [1999] 3 SLR 65 at 74 para 25.)

49. In Australia it has been said:

> *"[23] It would be difficult for the Court to over-emphasise the importance of the director's statutory law rights of access to corporate information. They are the foundation of the system of corporate governance as it exists in Australia today. Directors cannot be expected to carry out any of their substantial responsibilities, including their fiduciary duties and their duties to attend to the solvency of the company and its general management, unless they can be sure of having full and unfettered access to the documents of the company. It is not appropriate for their fellow directors to offer to provide the requesting director with particular documents if that director requests those documents by name. What should happen, when documents are demanded by a director, is that the gate is opened wide and the*

[20] This paper does not deal with the fascinating question of how far the knowledge and information of the nominee director may be attributable to the appointor and the difficulties that this can create in, for example, the context of takeover disclosures and insider dealing provisions in the context of offers by a joint venture: see e.g. *Austen & Butta Ltd v Shell Australia Ltd* (1992) 10 ACLC 610 and, as regards attribution of knowledge of the nominee to the appointor: the analysis in the Law Commission (UK) Consultation Paper No. 124 "Fiduciary Duties and Regulatory Rules: A Consultation Paper".

[21] See *Burn v London South Wales Coal Co.* (1890) 7 TLR 118, cited in *Conway v Petronius Clothing Co.* [1978] 1 WLR 72.

director has full and unfettered access at all reasonable times."(Fox v Gadsden Pty Ltd (2003) 46 ACSR 717 (Austin J).

50. The common law right is not limited to accounting or financial books and records but encompasses all books and records of the company, whether or not there is a specific statutory right to inspect. This of course follows from the underlying rationale of the principle. See e.g.

Burns v London and South Wales Coal Company [1890] W.N. 209 (access to debenture trust deeds and documents connected with the issue and modification of the terms of the debentures)

McCusker v M'Rae [1966] S.C. 254 (access to minutes of general meetings and of meetings of directors in addition to books of account).

Wuu Khek Chaing George v ECRC Land Pte Ltd [1999] 3 SLR 65 at 74 para 25.

In re Jervois Mining Ltd, Campbell v Jervois [2009] FCA 316 at paras 45 and see form of order. (share register, documents relevant to issuing of shares and documents relevant to appointment of proxies to act at an EGM).

51. In some cases, statute provides a right of inspection of particular books and records (most commonly accounting records). In *Conway v Petronius* Slade J was of the view that the relevant English statutory provision regarding financial records simply laid down a criminal sanction and conferred no civil right enforceable by injunction. Instead the common law right remained. That has been doubted in other jurisdictions with statutes in effectively the same material terms. In *Oxford Legal Group v Sibbasbridge* [2008] EWCA Civ 387, the court did not consider it necessary to resolve the point. It is suggested that the only real question for the Court is whether the statutory right (if such it is) has in some way varied or altered the common law (see *Sibbasbridge* at paragraphs [19] to [23] and *Wuu Khek Chaing George v ECRC Land Pte Ltd* [1999] 3 SLR 65).[22]

[22] See e.g. Companies Act, s199(5) (Singapore) and Corporations Act s290 (Australia).

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52. However, as with the exercise of any power, the power must be exercised for the purpose for which it is conferred. If it is exercised for a collateral purpose, then the Court will, on appropriate application, restrain a relevant attempted exercise. Whether this is because the power does not exist if sought to be exercised for a collateral purpose or because such attempted exercise would be an abuse of the power is an interesting jurisprudential question which may be of more academic than practical significance.

53. In the case of a nominee director, may the director exercise the power to assist him in looking after his nominator's interests and what duties of confidentiality will he owe to the company as regards any passing on to his nominator of any information that he obtains?

54. Usually, this is a matter that should be dealt with expressly in the relevant agreements and constitutional documents that comprise the joint venture documentation. In particular it will be important to spell out that the nominee director is entitled to information and to use it in looking after the sectional interests of his appointor as one of the joint venturers as well as identifying which information can be passed to his appointor and in what circumstances.

55. Sometimes the documents prepared do not deal with the situation in great detail. In *Berlei Hestia (NZ) Ltd v Fernyhough* [1980] 2 NZLR 150, The Supreme Court in New Zealand had to consider the position in the context of a New Zealand joint venture company. In that case 40% of the shares were held by one of the joint venturers, an Australian company. The remaining shares were held by New Zealand shareholders. Each of the Australian and the New Zealand shareholders as separate groups could appoint 3 directors each and there was no casting vote in the event of deadlock. When the New Zealand company began to compete with its Australian shareholder in Australia there was a breakdown in relations between the Australian and the

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New Zealand shareholders. The New Zealand shareholders adopted accounting procedures which would cause a loss of dividend to the Australian shareholder. Those accounts remained unapproved. The New Zealand directors also purported to exclude the Australian directors from management of the company and information about the company on the ground that they were business rivals. The Australian company successfully sought injunctions to prevent this conduct. Mahon J accepted that the Australian directors had been shown to be in a position to act in derogation of their duty to the company but said that was not enough. What had to be shown to justify their exclusion from relevant information was that there was an actual intention to use corporate information in breach of duty for the benefit of the company's competitors. On the evidence that was not made out. Mahon J considered the nature of the fiduciary duty owed by the nominee directors. Without coming to a final view, he suggested that in circumstances such as those he was dealing with, where articles are agreed giving specific shareholders or group of shareholders the right to nominate its own directors, there may be grounds for saying that in addition to their duties to the shareholders as a whole they may have a special responsibility towards those who nominated them. That would be on the basis that the articles were constructed with the intent and belief that the institution of such a special responsibility towards one class of shareholders was conducive to the interests of the company as a whole. He suggested that the corporators should be able to agree upon "*an adjusted form of fiduciary liability, limited to circumstances where the rights of third parties vis-á-vis the company will not be prejudiced.*" He noted the views of Professor Finn[23] that the position has already been reached where nominee directors will be absolved from suggested breaches of duty to the company merely because they act in furtherance of the interests of their appointors, provided that their conduct accords with the bona fide belief that the interests of the corporate entity are likewise being advanced"

[23] Finn, *Fiduciary Obligations* (1977) para 114.

56. Mahon J referred to the cases of *Levin v Clark* [1962] NSWR 686 and *Re Broadcasting Station 2GB Pty Ltd* [1964-65] NSWR 1648.

56.1. In *Levin v Clark*, the Plaintiff purchased a major shareholding in a company and took a mortgage from the vendor mortgagee. The company's constitution provided for the appointment of two governing directors which positions were held by individuals associated with the vendor. It was arranged they would remain but not exercise their powers as such directors unless the Plaintiff defaulted under the mortgage. When the Plaintiff did default the governing directors attempted to exercise their powers. The Plaintiff sought to restrain them on various grounds including that in so acting they would be acting in the mortgagee's interest, rather than the company as a whole, in breach of their fiduciary duty. The argument failed. Jacob J stating that the breadth of the fiduciary duty had been narrowed by agreement amongst the body of the shareholders.

56.2. In *Re Broadcasting Station 2GB Pty Ltd* it was alleged, in statutory oppression proceedings, that the new controller of the company (Fairfax) had appointed nominee directors who were acting in its interests by following its wishes without proper consideration of the separate interests of the company 2GB. Jacob J rejected the claim. He found that the conduct of the nominees would not be reprehensible "*unless it can also be inferred that he directors, so nominated, would so act even if they were of the view that their acts were not in the best interests of the company*". There was no evidence that the directors believed that their conduct was not in the interests of 2GB.

57. In *Japan Abrasive Materials Pty Ltd v Australian Fused Materials Pty Ltd* (1998) 16 ACLC 1,172 the company in question was a joint venture between three shareholders. Each held a third of the shares with a right to appoint two directors. A majority of shareholders and directors wished to expand the company's plant over the objections of the Plaintiff. Proceedings followed.

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One of the arguments of the Plaintiff was that the directors of the company were entitled to vote entirely in accordance with the wishes of their appointor. The defendants contended that the directors must have regard only to the interests of the company itself. Clause 4.10 of the shareholders' agreement provided that unanimous consent, of shareholders or directors, was required if a resolution dealt with (among other things) expansion of the company's plant. Clause 4.10 was said by the Court[24] to have attenuated the duties of the directors on the basis that a clause 4.10 matter could be said to be in the interests of the company only if the requirement of unanimous consent was met. Clause 4.10 equated the position of shareholders and directors and thus permitted the directors to vote in accordance with the wishes of the joint venturers so that the same result was achieved as if the matter had been voted upon at a general meeting of shareholders: "*If unanimous agreement cannot be reached then it cannot be said to be in the interests of the corporators as a whole that the project should proceed. In other words it is not in the interests of the Company*" (per Templeman J).

58. This line of authority has been considered further more recently in England. In *Re Neath Rugby Lt*d [2007] EWHC 1789 (ch); [2008] 1 BCLC 527, HH Judge Havelock-Allan QC considered, as well as the 2GB case, two more recent Australian cases: *Re News Corp Ltd* (1987) 70 ALR 419 and *CanWest Global Communications Corp v Australian Broadcasting Authority* (1997) 24 ACSR 405. The issue he had to decide was whether a petition relying on the statutory remedy for unfair prejudice, should be struck out or permitted to continue to trial. One issue was whether an allegation that (in effect) a nominee director had failed to consult his appointing company as to his conduct as a nominee director, in breach of an implied duty arising from the circumstances in which he was appointed, and that this had caused unfair prejudice should be permitted to proceed. The Judge concluded the claim could proceed and that a nominee had to act in the best interests of the

[24] The Supreme Court of Western Australia.

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company of which he was a director but that he could have regard to the interests or requirements of his appointor to the extent that they were not incompatible with his duty to act in the best interests of the company. The trial Judge, Lewison J, considered that the position was slightly different and that the nominee director was required to act in the best interests of his company. However, that was on the basis that on the facts there was no agreement or implied term requiring the nominee to act otherwise or in a manner that could give rise to a conflict.

59. The issue surfaced again in England in the case of *Cobden Investments Ltd v RWM Langport* [2008] EWHC 2810 (Ch). Warren J concluded (among other things) that:

59.1. duties could be attenuated or relaxed by unanimous agreement of the shareholders;

59.2. it was doubtful that the duty to act in the best interests of the company could be released (and the cases cited to him all envisaged that the consideration of the interests of the appointor would still be consistent with acting in the company's best interests);

59.3. in relation to specific areas of interest a director could be released from his fiduciary duty to give his best independent judgment to the company. In particular if a director is charged with negotiating on behalf of his appointor an agreement with the company, where the interests of the company and the appointor are opposed, he considered that the shareholders could, unanimously, agree that such negotiation could be conducted without regard to the interests of the company. However, he noted an "expectation" that in such circumstances the director would by the same agreement, be precluded from board discussions relating to the issue and from voting on them.

59.4. Finally he noted that the extent of the duties of a director in such a situation is very fact specific. The difficult question will be the extent to which the duty is qualified and that will "*depend critically on the context*

of the relationship and the particular action which is said to constitute a breach of duty."

60. The factual situation in that case was that the company was a joint venture company between two family interests. Each family was entitled to appoint directors but the individuals had to be approved by the other family. The approval of individuals who were directors of the relevant family company was so agreed by the other family. Warren J decided that as regards matters which were the subject of interlocking agreements under the joint venture, the nominee directors in question were entitled to act as directors of the family company BUT that if they sought to influence the board of the joint venture company or themselves make decisions as part of the board of that company or otherwise on those matters then they had to do so in a manner which they considered to be in the best interests of the joint venture company.

61. What one seems to be seeing is a situation where the courts have moved from the concept of simply identifying the interests of the company as being, in part, to keep a group of shareholders content to a situation where the overall agreements and arrangements are accepted as being capable of moulding the form and content of the fiduciary duty in question. As such it requires any person advising on the setting up of joint venture arrangements to take very great care in this area.

Conclusions

62. I tentatively suggest that the current state of the law in the UK as regards nominee directors in the joint venture context is as follows:-

62.1. As in the case of directorships of competing companies,[25] the Courts have been less rigorous in the application of the "no conflict" rule in the

[25] See e.g. the *London & Mashonaland* case ([1893] WN 165. One suggestion in the cases is that the very rigorous rule of possible conflict applies in the case of making profits but not in this sort of area and that the court will only intervene if there is an actual conflict. The "generosity" of this approach

context of joint ventures and nominee directors. Unless there is a very clear case of actual conflict, the focus in the cases has been on the duty to act bona fide in the best interests of the company.

62.2. We do seem to have reached the position that in the joint venture context the courts will readily imply that the nominee can take into account and act in the interests of his appointor, without being in breach of duty to his company, provided that this he or she is also consistently acting bona fide in the interests of the company.

62.3. The duty to act bona fide in the interests of the company and indeed the duty to avoid conflicts can be shaped by the overall joint venture arrangements.

62.4. However, the precise extent of the duties of the nominee director to his company in the joint venture context is highly fact specific depending on the overall context of the joint venture relationship and arrangements and the specific action which is being evaluated for the purposes of determining whether it amounts to a breach of duty.

Statutory intervention

63. Finally I must refer to the possibility of statutory intervention in this area. In practice this seems to have been most considered or implemented in New Zealand and Australia.

64. In New Zealand, s131(2) of the New Zealand Companies Act 1993 as amended in 1997[26] provides as follows:

Directors' duties

131 Duty of directors to act in good faith and in best interests of company

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is perhaps demonstrated by *Trounce & Wakelfield v NCF Kaipoi* (1985) 2 NZCLC 99,422. Nominee directors obtained an injunction restraining the company from excluding them from meetings of the board relating to a takeover offer for the company. They were also directors of the offeror company which was a wholly owned subsidiary of their appointor. It was said to be wrong to apply the no conflict principle laid down in *Aberdeen v Blaikie Bros.* and subsequent cases removed as the case was not one of profit and there was simply an anticipation of a breach of duty.

[26] Section 131(4) amended, on 30 June 1997, by section 11 of the Companies Act 1993 Amendment Act 1997 (1997 No 27).

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(1) Subject to this section, a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company.
(2) A director of a company that is a wholly-owned subsidiary may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company, act in a manner which he or she believes is in the best interests of that company's holding company even though it may not be in the best interests of the company.
(3) A director of a company that is a subsidiary (but not a wholly-owned subsidiary) may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company and with the prior agreement of the shareholders (other than its holding company), act in a manner which he or she believes is in the best interests of that company's holding company even though it may not be in the best interests of the company.
(4) A director of a company that is carrying out a joint venture between the shareholders may, when exercising powers or performing duties as a director in connection with the carrying out of the joint venture, if expressly permitted to do so by the constitution of the company, act in a manner which he or she believes is in the best interests of a shareholder or shareholders, even though it may not be in the best interests of the company.

65. On the face of things, there must be a real question as to whether this would reverse the result in a case such as *Scottish Co-Operative v Meyer*. Of course, the practical answer may be that in any particular factual situation any express attenuation of duties would not be conferred in blanket terms.

66. A similar proposal was considered in relation to Australia by the Companies and Securities Law Review Committee in its Report no 8 on Nominee Directors and Alternate Directors (1989). The suggestion was that directors of a solvent company would not be in breach of their duty for taking into account a sectional interest in three cases, namely where:

66.1. all the members assented to the particular exercise of the power;

66.2. the company was being administered under a shareholders' agreement (including the agreement underlying a joint venture company); or

66.3. the company was a wholly owned subsidiary and the directors acted in the interests of the parent.

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67. The recommendation was not adopted. However a new s187 was introduced into what is now the Corporations Act 2001 by the Corporate Law Economic Reform Program Act 1999 (Cth) which introduced changes as regards directors of wholly owned subsidiaries, similar to that in s131(2) of the New Zealand provision. Essentially the section deems a director of the wholly-owned subsidiary who acts in the interests of the holding company to have complied with his or her duty to act in the best interests of the subsidiary if three requirements are met:

67.1. the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company;

67.2. the director acts in good faith in the best interests of the holding company;

67.3. the subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director's act.

68. The matter was considered again in Australia by the Companies and Securities Advisory Committee in its "*Corporate Groups: Final Report (May 2000).*" The conclusion was that no legislation was needed to deal with the position.

69. The moral from all of this is very clear: careful though and consideration must be given to the operation of the joint venture and the duties and roles of any nominee directors. What has to be considered is not simply whether nominee directors of the joint venture company may also remain active directors of one of the joint venturers but what is to happen with regard to certain situations which may arise, such as:

69.1. the information that the nominee is entitled to in any situation;

69.2. the information that the joint venturer may be entitled to and/or that the nominee can pass on to the joint venturer;

69.3. whether nominee directors can be directors of both the joint venturer and the joint venture company;

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69.4. whether nominees may act for the joint venturer notwithstanding what would otherwise be a conflict and still remain a director of the joint venture company and if so, what limits apply to their acting for the nominee company and in this context and in particular what is to happen in circumstances where for example:

(a) the joint venture arrangements are directed to provide that unanimous agreement is necessary to proceed on a specific course of action

(b) the joint venture arrangements make specific provision or envisage certain arrangements between a joint venture and the company mnts(e.g. where they provide for some contract or other arrangements between joint venturer and joint venture company such as a lease or commercial contract or

(c) in circumstances which would not otherwise be part of the joint venture arrangements (eg. if a joint venturer wishes in the future to expand its business into areas that the joint venture company is involved in or take advantage of opportunities in that respect).

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Annex

Construction and interpretation of agreements

Jackson v Griffiths

Summary of propositions regarding the construction of agreements and the implication of contractual terms

(see paragraph 22 of the paper of which this annex forms part)

per Briggs J:

"Objective Process

(i) Construction (or as I would prefer to call it interpretation) is, in relation to any point at issue, the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

(ii) For that purpose, even though the point in issue may be a narrow one, the interpretation of the relevant provision depends upon an understanding of its context within the agreement as a whole.

(iii) The court's function is to ascertain the meaning of the agreement rather than to seek to improve upon it, or put right any inadequacies of meaning. Nonetheless the court recognizes that draftsmen may make mistakes, may use occasionally inappropriate language and may fail expressly to address eventualities which may later occur.

Implied terms

(iv) the implication of terms is no less a part of the process of ascertaining the meaning of an agreement than interpretation of express terms. Implication addresses events for which the express language of the agreement makes no provision.

(v) In such a case the usual starting point is that the absence of an express term means that nothing has been agreed to happen in relation to that event. But implied terms may be necessary to spell out what the agreement means, where the only meaning consistent with the other provisions of the document, read against the relevant background, is that something is to happen.

(vi) Although necessity continues (save perhaps in relation to terms implied by law) to be a condition for the implication of terms, necessity to give business efficacy is not the only relevant type of necessity. The express terms of an agreement may work perfectly well in the sense that both parties can perform their express obligations, but the consequences would contradict what a reasonable person would

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understand the contract to mean. In such a case an implied term is necessary to spell out what the contact actually means.[27]

Commercial common sense

(vii) The dictates of common sense may enable the court to choose between the alternative interpretations (with or without implied terms), not merely where one would "flout" it, but where one makes more common sense than the other. But this does not elevate commercial common sense into an overriding criterion, still less does it subject the parties to the individual judge's own notions of what might have been the most sensible solution to the parties' conundrum."

Notes: regarding proposition (vi)

1. The Court of Appeal noted that the parties had disagreed about proposition (vi).
2. Counsel for the defendants submitted that this sub-paragraph smacked of a potential re-writing of contracts to achieve what the court perceived to be a "sensible" or reasonable commercial result. He submitted that such a tendency would run counter to the approach of the House of Lords in *Liverpool City Council v Irwin* [1977] AC 239 in which any idea of a mere perception of "reasonableness", as a touchstone of the implication of contractual terms, was rejected.
3. Counsel for Mr Jackson referred to Lord Hoffmann's judgment in the *Belize* case at paragraphs 21 – 23 of the judgment. In particular Lord Hoffmann said:

   > "22…….it is not enough for a court to consider that the implied term expresses what it would have been reasonable for the parties to agree to. It must be satisfied that it is what the contact actually means.
   > 23. The danger lies, however, in detaching the phrase "necessary to give business efficacy" from the basic process of construction of the instrument. It is frequently the case that a contract may work perfectly well in the sense that both parties can perform their express obligations, but the consequences would contradict what a reasonable person would understand the contract to mean."
4. The Court of Appeal did not consider it necessary for the purposes of the appeal "to resolve this brief conundrum."

Subsequent variation; waiver

Finally, and in the context of joint venture agreements, it should be recognized that articles of association and agreements between shareholders can, like any other contract, be varied by subsequent agreement which may itself be express or inferred from conduct. In the case of waiver or acquiescence, it may be open for one party to insist, upon reasonable notice, on the original agreement being adhered to: see *Anderson v Hogg* (2000) SLT 634 and *Fisher v Cadman* [2006] 1 BCLC 499.

[27] See Notes below.

Finance, Property and Business Litigation in a Changing World

Concurrent Session 3A: Derivative Actions and Minority Oppression

Chairperson

Associate Professor Lee Pey Woan, *School of Law, Singapore Management University*

Speakers

Professor Tan Cheng Han SC, *Faculty of Law, National University of Singapore*

Mr Martin Moore QC, *Erskine Chambers*

Mr Thio Shen Yi SC, *TSMP Law Corporation*

Ms Anna Markham, *4 Stone Buildings*

Derivative Actions and Minority Oppression

SAL/ChBA Conference

Practical problem

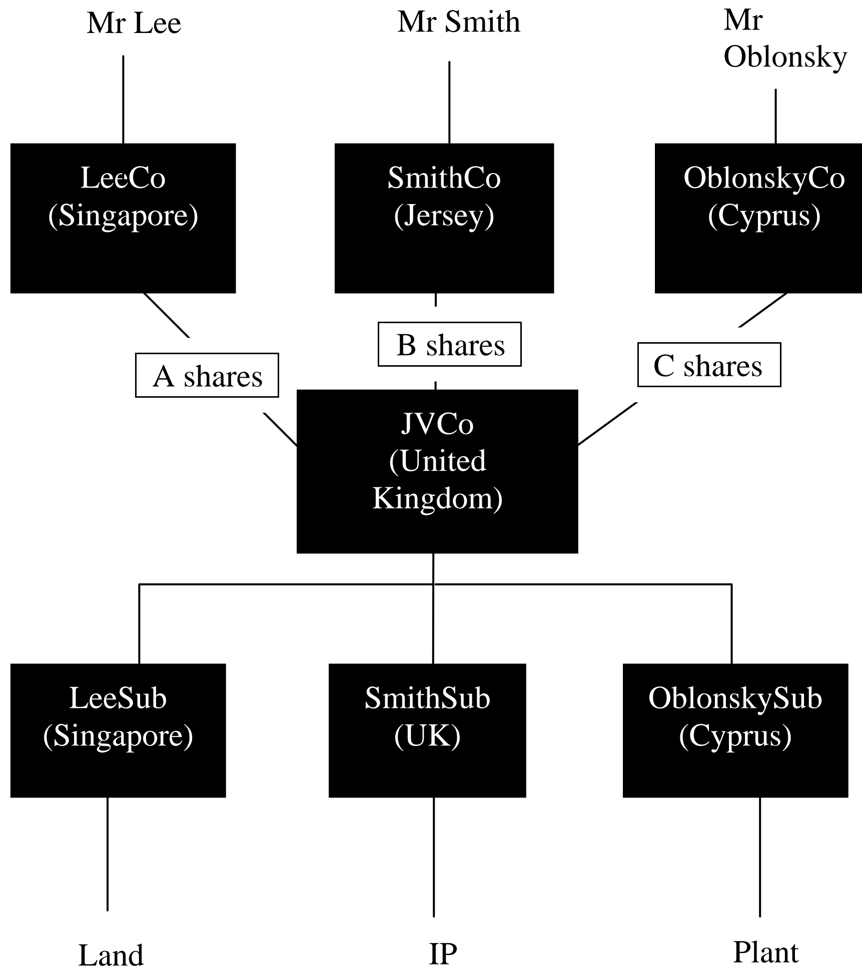
Three international businessmen wish to come together in a joint venture for the exploitation of palm oil. They are:

- Mr Lee, a Singaporean resident, who owns, together with his family trusts, 100% of the shares in LeeCo. LeeCo is incorporated in Singapore and owns a 10,000 hectare plantation in Indonesia. It has a right of pre-emption over a neighbouring estate of 15,000 hectares which expires in 18 months.

- Mr Smith, a United Kingdom resident, who owns, together with his family trusts, 100% of the shares in SmithCo. SmithCo is incorporated in Jersey and owns the intellectual property rights to a new and more efficient palm oil extraction process;

- Mr Oblonsky, a Russian resident, who owns together with his family trusts, 100% of the shares in OblonskyCo. OblonskyCo is incorporated in Cyprus owns and manages a palm oil extraction plant next door to LeeCo's estate.

The co-venturers agree to hive down the business of each of their respective companies to an operating subsidiary called respectively LeeSub, SmithSub and OblonskySub. LeeCo agrees to transfer LeeSub to JVCo, a company incorporated in England, in return for the allotment and issue of a special class of A shares, all of which are held by LeeCo. SmithCo and OblonskyCo make the same arrangement with their operating subsidiaries and each receives respectively the entire class of B and C Shares. The structure of the arrangements can be shown diagrammatically thus:



The Articles of Association of JVCo are prepared by Sloppy and Sleepy LLP, Mr Oblonsky's lawyers and provide that the rights attached to the A shares entitle the holder to appoint and remove one A director. The B and C shares carry the same right to appoint and remove a B and C director respectively. The quorum provisions relating to board meetings require all directors to be present. Mirror rights are given in relation to the boards of the operating subsidiaries.

The Articles do not contain any equivalent provisions in relation to general meetings and simply provide for one vote per share. It is not clear if this is an error or on instructions from Oblonsky. Lee and Smith do not notice the omission.

The JVCo, LeeCo, SmithCo and OblonskyCo enter into a JV agreement which provides for :

1. the allotments referred to above;
2. the provision of all of LeeSub's crop to OblonskySub's plant and that it will hold the pre-emption right on trust for the JVCo;
3. the licensing by SmithSub of its IP to OblonskySub for use at OblonskySub's plant;
4. the processing, using the IP, of all of LeeSub's crop at the plant;
5. equal sharing of all profits where the IP has been used;

6. certain restricted matters requiring the unanimous consent of the shareholders which include material transactions, sub-licensing and litigation;
7. the title of the C Director to be Chief Executive.

The JV Agreement provides that the shareholders will co-operate with each other in the running of the business of the JV in accordance with sound commercial profit making principles to the best advantage of the JV and each shareholder and to act reasonably and in good faith toward each other.

Each of Lee, Smith and Oblonsky exercise their rights to be appointed to the boards of each relevant company.

Things do not go well.

The estate neighbouring LeeSub's come up for sale and Lee puts to the board of the JVCo that the JVCo should buy. Smith disagrees on commercial grounds but Oblonsky declines because he wishes to acquire it himself. He does so, through another company, after the end of the pre-emption period. Furthermore, he puts the crop from that estate through a third party wholly independent processing plant to whom he has licensed the IP pursuant to a sub-licence signed by him as chief Executive of JVCo and SmithSub.

Lee and Smith find out. What proceedings would you advise be started, by whom and where?

Would your answer be different if

(a) the directors of the JVCo include 3 non-executive directors. One each introduced to the JV by each of Lee, Smith and Oblonsky but agreed to by all; or

(b) the boards of the operating subs comprised only appointees of the contributing shareholder?

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DERIVATIVE ACTIONS AND MINORITY OPPRESSION

MARTIN MOORE QC

Erskine Chambers

THE PROPER PLAINTIFF RULE

- Fundamental principle of any rational system of law that the proper person to complain of a wrong is the person who suffered it.

- In the current context, that is the company.

THE PROPER PLAINTIFF RULE

- In all jurisdictions the rule finds expression in
  - Judge made rules. The rule in Foss v Harbottle (1843) 2 Hare 461 as in Channel Islands now or the UK prior to 1.10.07 for single derivative actions and, possibly, still for double derivative.
  - Statutory provision. Part 11 of Companies Act 2006 in UK. Singapore, New Zealand, Australia, Hong Kong, US and BVI also have statutory provisions.

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THE RULE IN FOSS v HARBOTTLE

- The rule:
  - Proper plaintiff in respect of a wrong done to a corporation is the corporation
  - If the wrong can be ratified and made binding on the corporation by a simple majority no member of the corporation can maintain the action
- Best exposition is in *Prudential Assurance Co. Ltd v Newman Industries (No2)* 1 Ch.204 citing *Edwards v Halliwell* [1950] 2 All.E.R. 1064

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FOSS v HARBOTTLE: THE EXCEPTIONS

- The exceptions:
  - The ultra vires exception
  - The super majority exception
  - The wrongdoer control exception or fraud on the minority
  - Illegality
    - Conduct illegal by reason of the general law
    - Conduct prohibited by statute to which the company owes its existence
  - Interests of justice?

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Part 11 Companies Act 2006

- Part 11, Ss.260-269 new statutory basis for derivative actions
- Requirement for leave of court retained
- Into force 1st October 2007
- Significant changes to law
  - Claims in negligence even where the director has not benefitted personally;
  - If the conduct was capable of ratification by the independent members not now an absolute bar

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Part 11 Companies Act 2006

- New procedure applies to all claims but if conduct complained of occurred prior to 1.10.07 Court must apply the old common law

- Test for permission is wider and more general

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Part 11 Companies Act 2006

- S.261(2) Stage One – issue of claim form/application for permission to continue. Consideration by Court to see if prima facie case required

  - If refused, the member might seek permission at an oral hearing

  - If granted, the Court will give directions for formal service of the claim form and application to continue

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Part 11 Companies Act 2006

- S.263(2) Stage Two – mandatory filter

  - if a person acting in accordance with S.172 duty would not seek to continue the claim: S.263(2)(a)
    - Interpreted as no director acting reasonably would continue the claim

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

  - if the act or omission has been ratified or authorised: S.263((2)(b) & (c)

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Part 11 Companies Act 2006

- S.263(3) Stage Two - discretionary filter: List of factors
  - Good faith of applicant
    - Stimpson v Southern Private Landlords Assoc [2010] BCC 387
  - Importance hypothetical director attach to continuing it
    - Mission Capital plc v Sinclair [2010] 1 BCLC 304
  - Likelihood of authorisation or ratification

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Part 11 Companies Act 2006

- Any decision of company not to proceed
- Majority control
  - Wishart v Castlecroft Securities Ltd [2009] CSIH 65
  - Cinematic Finaince Ltd v Ryder [2010] EWHC 3387(Ch)
  - Bamford v Harvey [2012] EWHC 2858 (Ch)

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- Alternative remedies
  - Franbar Holdings Ltd v Patel [2009] 1 BCLC 1
  - Kleanthous v. Paphitis [2011] EWHC (Ch)
  - Phillips v Fryer 12 June 2012
- Attitude of independent members: Court to pay particular regard to any evidence before it as to views of members who have no personal interest, direct or indirect, in the matter – S.263(4)

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HEADER

- Court proving pro-active and engaged and applied a relatively tight filter
  - Kiani v Cooper [2010] EWHC 577(Ch)
  - Stainer v. Lee [2010] EWHC 1593 (Ch)
    - Leave given until disclosure;
- Costs
  - Stainer v Lee: costs indemnity up to £40,000
  - Carlisle & Cumbria United Supporters Society v Story [2010] EWCA Civ 463
- Leave to settle likely to be required
- No cases so far against large plcs by special interest or activist shareholder groups

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Double derivative claims

- Companies Act 2006
  - Lord Millett: Gore-Browne Bulletin August 2010
  - Not available as a matter of construction

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DOUBLE DERIVATIVE CLAIMS

- Common law
  - Existence assumed - Wallensteiner v Moir (No2) [1975] 1 QB 373; Halle v Trax [2000] BCC 1020
  - Express reservation of common law in HK Statute - Waddington v Chan [2008] HKCU 1381 [2009] 2 BCLC 82
  - Available at common law notwithstanding Part 11-Universal Project Management Services Limited v Fort Gilkicker Limited [2013] EWHC 348 (Ch)

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Double derivative actions – really?

- Necessity?
- Collision with reflective loss principle?
- Parliamentary intention?
- The ghost of Foss v Harbottle?
- Wait until the Court of Appeal say so

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International Aspects

- Procedural or substantive rule of law
- Why does it matter?
  - In an international context, lex fori governs questions of procedure
  - In a domestic context, possibly encourage judicial innovation

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International Aspects

- UK and US view as substantive in an international context
  - Konamaneni v Rolls Royce Industrial Power (India) Ltd [2002] 1 BCLC 336 para 50 and 65
  - Base Metal Trading v. Shamurin 2005 2 BCLC 171 @ para 68
  - Vaughn v LJ Int'L, Inc 94 Cal.Rptr.3d 166, 171

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International Aspects

- In Australia and Hong Kong viewed as procedural
  - Virgtel v Zabusky [2006] QSC 66
  - East Asia Satellite TV v. New Citai LLC HCA 2189/2009

International Aspects

- Words "procedural" and "substantive" are not talismanic
- Australian and Hong Kong cases remarks are obiter
- Substantive law relating to
  - Status of a company as a separate legal entity
  - Questions of authority and the allocation of power amongst organs of the company

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ANNA MARKHAM

4 Stone Buildings

UNFAIR PREJUDICE: THE ENGLISH PERSPECTIVE

UNFAIR PREJUDICE

- English Courts traditionally slow to interfere in internal management of a company.
- CA 1948, s210 – "oppressive" terminology.
- Now CA 2006, s994 (formerly CA 1985, s459).
- Applied flexibly.

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Companies Act 1948

210 Alternative remedy to winding up in cases of oppression
(1) Any member of a company who complains that the affairs of the company are being conducted in a manner oppressive to some part of the members (including himself)...may make an application to the court by petition for an order under this section.

[...].

Companies Act 2006

994 Petition by company member
(1) A member of a company may apply to the court by petition for an order under this Part on the ground–
(a) that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself), or
(b) that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.
[...].

WHO CAN COMPLAIN?

- A member or group of members (non-controlling): *Re Legal Costs Negotiators.*
- A nominee: *Atlasview v Brightview.*
- Transferees and transmittees: s994(2).

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Re Legal Costs Negotiators [1999] BCC 547.

Atlasview v Brightview [2004] BCC 542.

Companies Act 2006

994 Petition by company member

[...]
(2) The provisions of this Part apply to a person who is not a member of a company but to whom shares in the company have been transferred or transmitted by operation of law as they apply to a member of a company.
[...].

"COMPANY'S AFFAIRS"

- Very broad words – to be construed liberally.
- Flexible approach to parent/subsidiary division, especially where same directors : *Gross v Rackind*.
- Omissions count too: *Scottish Co-operative Wholesale Society v Meyer* and CA 2006 s994(1)(b).

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FINANCE, PROPERTY AND BUSINESS LITIGATION IN A CHANGING WORLD

Gross v Rackind (CA) [2005] 1 WLR 3505.

Scottish Co-operative Wholesale Society v Meyer (HL) [1959] AC 324.

994 Petition by company member
(1) A member of a company may apply to the court by petition for an order under this Part on the ground–
[...]
(b) that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.
[...].

"UNFAIRLY PREJUDICIAL"

- "Deliberately imprecise": *Re Saul D Harrison plc.*
- Broader than "oppressive" as per CA 1948, s210.
- Context/background very important: O'*Neill v Phillips.*

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FINANCE, PROPERTY AND BUSINESS LITIGATION IN A CHANGING WORLD

Re Saul D Harrison plc [1995] 1 BCLC 14 at 17-20, per Hoffmann LJ.

O'Neill v Phillips [1999] 1 WLR 1092 at 1098, per Lord Hoffmann.

RELEVANT CONTEXT

- Court looks to "real bargain" between members.
- Articles of Association, shareholders' agreement, etc.
- Quasi-partnership?
- Directors' duties: now ss171-177 CA 2006.

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FINANCE, PROPERTY AND BUSINESS LITIGATION IN A CHANGING WORLD

"Real bargain" – per *O'Neill v Phillips* [1999] 1 WLR 1092, 1102.

CLAIMANT'S CONDUCT?

- Modern approach pragmatic: *R & H Electrical.*
- Claimant may have brought exclusion upon himself: *Mears v Mears.*
- But no positive requirement of diligence: *Re Annacott Holdings Ltd.*

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FINANCE, PROPERTY AND BUSINESS LITIGATION IN A CHANGING WORLD

R & H Electrical v Haden Bill Electrical [1995] 2 BCLC 280.

Mears v Mears [2002] 2 BCLC 1.

Re Annacott Holdings Ltd (CA) [2013] EWCA Civ 119*,* reported as *Re Tobian Properties Limited; Maidment v Attwood* [2013] BCC 98.

INTERESTS OF MEMBERS

- Prejudice to interests as a shareholder, but…
- Avoid narrow, technical construction: *R& H Electrical*; *O'Neill v Phillips*.
- Flexible approach extends to insolvency: *Gamlestaden*; *Re Annacott Holdings Ltd*.

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R & H Electrical Ltd v Haden Bill Electrical Ltd [1995] 2 BCLC 280, approved by the House of Lords in *O'Neill v Phillips* [1999] 1 WLR 1092 at 1105.

Gamlestaden Fastigheter AB v Baltic Partners Ltd [2007] 4 All ER 164, PC.

Re Annacott Holdings Ltd (CA) [2013] EWCA Civ 119, reported as *Re Tobian Properties Limited; Maidment v Attwood* [2013] BCC 98.

REMEDIES

- CA 2006, s996.
- Usual award: buyout order.
- Flexible approach to share valuation.
- Modern case management: split trial.

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FINANCE, PROPERTY AND BUSINESS
LITIGATION IN A CHANGING WORLD

Companies Act 2006

996 Powers of the court under this Part

(1) If the court is satisfied that a petition under this Part is well founded, it may make such order as it thinks fit for giving relief in respect of the matters complained of.
(2) Without prejudice to the generality of subsection (1), the court's order may–
(a) regulate the conduct of the company's affairs in the future;
(b) require the company–
(i) to refrain from doing or continuing an act complained of, or
(ii) to do an act that the petitioner has complained it has omitted to do;
(c) authorise civil proceedings to be brought in the name and on behalf of the company by such person or persons and on such terms as the court may direct;
(d) require the company not to make any, or any specified, alterations in its articles without the leave of the court;
(e) provide for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, the reduction of the company's capital accordingly.

POLICY CONSIDERATIONS

- Encourages proper corporate behaviour in smaller companies.
- Gives investors grounds for confidence.
- UK Company Law Review (2001) rejected proposals for reform.

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FINANCE, PROPERTY AND BUSINESS LITIGATION IN A CHANGING WORLD

JURISDICTIONAL ASPECTS

- Only English companies: CA 2006 s994(3); s1(1).
- These disputes amenable to arbitration: *Fulham Football Club (1987) Ltd.*
- *Lex fori* considerations same as for derivative actions.

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FINANCE, PROPERTY AND BUSINESS LITIGATION IN A CHANGING WORLD

Companies Act 2006

1 Companies

(1) In the Companies Acts, unless the context otherwise requires–
"company" means a company formed and registered under this Act, that is– (a) a company so formed and registered after the commencement of this Part, or
(b) a company that immediately before the commencement of this Part–
(i) was formed and registered under the Companies Act 1985 (c.6) or the Companies (Northern Ireland) Order 1986 (S.I. 1986/1032 (N.I. 6)), or
(ii) was an existing company for the purposes of that Act or that Order,
(which is to be treated on commencement as if formed and registered under this Act).
[...]

994 Petition by company member

[...]
(3) In this section, and so far as applicable for the purposes of this section in the other provisions of this Part, "company" means–
(a) a company within the meaning of this Act, or
(b) a company that is not such a company but is a statutory water company within the meaning of the Statutory Water Companies Act 1991 (c.58).

Fulham Football Club (1987) Ltd v Richards [2012] Ch 333 (CA).

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DERIVATIVE ACTIONS AND MINORITY OPPRESSION

Prof. Tan Cheng Han, SC & Thio Shen Yi, SC

TSMP Law Corporation

Outline

- Why protect minority shareholders
- A snapshot of minority shareholder protection mechanisms
- A closer look at 2 key mechanisms:
  - *The Common law / Statutory Derivative Action*
  - *The Oppression Remedy*

Why protect minority shareholders?

- The starting point is decision-making by the majority
- Contract – minority shareholders freely choose to be minorities
- Economic efficiency – majority shareholders have the greatest incentive to maximize profits
- The concept of majority decision-making is reflected in *Foss v Harbottle* (1843) 2 Hare 461:
  - "Proper plaintiff" principle: The company, not a shareholder, is the 'proper plaintiff' in an action for a wrong done to it
  - "Majority rule" principle: Courts should not intervene where a majority of the shareholders may lawfully ratify an irregularity that forms the basis of the shareholder claim

Prof. Tan Cheng Han, SC & Thio Shen Yi, SC, *TSMP Law Corporation*

Why protect minority shareholders?

- Law and economics perspective- agency costs (Hansmann and Kraakman, *The Anatomy of Corporate Law* (Oxford:2009)):
  - Minority shareholders ('principals') depend on majority shareholders ('agents') for their welfare. Majority shareholders, having better information and more power, have incentives to act opportunistically against the interests of minority shareholders.
  - Similar 'agency costs' rationale for rules protecting
    - shareholders as a whole from directors' misconduct
    - creditors from directors' misconduct (e.g. in insolvency)

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Why protect minority shareholders?

- Corporate Constitutionalism (Stephen Bottomley, *The Constitutional Corporation: Rethinking Corporate Governance* (Oxford:2007))
  - A corporation is not only a nexus of contracts
  - Corporate governance is akin to a system of government
  - This constitutional analogy suggests increased 'participation, identity and identification, responsibility and obligation'
  - Minority shareholders are in a parallel position to ethnic or religious minorities in a state, and require analogous protections from the majority

A snapshot of minority shareholder protection mechanisms

Mechanism	Examples in Singapore company law	Comparative perspectives
Rules/standards	Oppression remedy (s.216 CA)	Equal treatment norm in various EU Directives (e.g. Art. 4 Directive 2007/36/EC), Japanese corporate law (Art. 109(1) Companies Act)
Governance rights (decision-making/appointment rights)	Supermajority approval requirement (75%) for: -alteration of memorandum (s.26(1) CA); -approval of takeover pursuant to scheme of arrangement (s.210(3) CA) Right to bring suit in the company's name (common law/statutory derivative action (s.216A CA)	Similar supermajority approval required for amendment of articles under s. 21, UK Companies Act 2006 Derivative action available in most jurisdictions -UK: s.260, UK Coy Act -Australia: Common law & s. 236, Corporations Act 2001

A snapshot of minority shareholder protection mechanisms

Mechanism	Examples in Singapore company law	Comparative perspectives
Entry and exit rights	Entry: Disclosure of critical corporate information at point of investment (e.g. Chapter 6, Prospectus Requirements under SGX Listing Manual) Exit: Right to sell shares on market for listed companies/transfer shares in public companies Mandatory bid rule in takeover situation which gives minority opportunity to exit at fair price where acquirer has acquired sufficient shares for control (Rule 14, Takeover Code)	Entry: Similar disclosure requirements in most jurisdictions' capital markets (EC Prospectus Directive, s.7, NYSE Listing rules etc.) Exit: Availability of appraisal rights in certain jurisdictions (e.g. US and Canada) for charter amendments that materially affect minority shareholder rights -US: § 13.02, Revised Model Business Corporation Act -Canada: s.190(3), Canada Business Corporations Act

(Reference: Hansmann and Kraakman (2009))

A closer look at 2 key mechanisms:

1) The common law/statutory derivative action

2) The oppression remedy

The common law/statutory derivative action

- **Issues**
  - Extension of the statutory derivative action (s.216A of the Companies Act) to listed companies?
  - Non-application of statutory derivative action to arbitrations
  - Single or dual derivative action regime
  - Multiple derivative actions
  - Meaning of "*good faith*" under S.216A of the Companies Act

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The common law/statutory derivative action: Overview

	Common Law DA	**Statutory DA (s.216A CA)**	**Comparison**
For what type of companies	Includes listed or incorporated outside of Singapore	Limited to unlisted and incorporated in Singapore	SDA not applicable for listed or foreign companies
Requirements for leave to bring action in company's name	Wrongdoers have benefited from wrong to company The benefit was at the expense of the company The wrongdoers have control of the company to prevent the action from being brought	Member has given proper notice to the board and board does not commence action **<u>Member is acting in good faith</u>** and in the best interests of the company in bringing the action The action has a *prima facie* chance of succeeding	Easier to bring SDA: CLDA excludes pure negligence claims by requiring 'wrongdoer benefit' CLDA requirement of 'wrongdoer control' is difficult to prove given the existence of informal relationships which may give de facto control

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The common law/statutory derivative action

- Historical impetus for enacting the statutory derivative action regime in 1993

- Dan. Puchniak and Wee Meng Seng, 'Derivative actions in Singapore: mundanely non-Asian, intriguingly non-American and at the forefront of the Commonwealth' in *The Derivative Action in Asia* (Cambridge:2012)

  'Minority shareholders face tremendous difficulty if they want to sue a wrongdoing director on behalf of the company. The rule and the 'fraud on the minority' exception were the subject of sustained criticism by academic commentators. One by one, most jurisdictions with legal roots in the English system reformed their laws by either completely replacing the common law doctrine with a statutory derivative action provision or giving shareholders the *option* of relying on the 'fraud on the minority' exception or the statutory derivative provision. **Within this movement, Singapore was one of the earlier jurisdictions to enact a statutory derivative action in its company law**.' (emphasis added)

The common law/statutory derivative action

- Main Limitations of Statutory Derivative Action (s.216A CA):
  - Not currently applicable to listed companies
  - Not currently available in arbitration proceedings: *Kiyue Co Ltd v Aquagen International Pte Ltd* [2003] 3 SLR 130
    - Minority shareholder not granted leave to intervene in arbitration between company and another party for purposes of defending and counter-claiming on behalf of company
    - Steering Committee Report has since proposed extension of S.216A to arbitration (June 2011)
    - Accepted by MOF (October 2012)

The common law/statutory derivative action

- Extension of the statutory DA to listed Singapore companies (whether in Singapore or overseas)
- Proposed by Steering Committee Report (June 2011) and accepted by MOF (October 2012)
- Previous reasons for excluding listed companies:
  - Fear that unscrupulous people would make frivolous applications to harass listed companies and manipulate the share price
  - Disgruntled shareholders of listed companies can exit by selling their shares in the open market
  - Listed companies are already monitored by various regulatory agencies

The common law/statutory derivative action

- Dan. Puchniak and Wee Meng Seng, 'Derivative actions in Singapore: mundanely non-Asian, intriguingly non-American and at the forefront of the Commonwealth' in *The Derivative Action in Asia* (Cambridge:2012)

  In defence of Singapore's decision to exclude listed companies in 1993…

  ' It is important to remember that in 1993, when section 216A was enacted, Singapore was one of the earliest Commonwealth jurisdictions to move away from the rule in *Foss*…At that time, neither the United Kingdom nor Australia – two of the most important jurisdictions in the Commonwealth, and the jurisdictions upon who Singapore relied mainly to model its Companies Act – had a statutory derivative action. Viewed against this backdrop…when the Singapore government decided to restrict (the statutory DA's) application, it was not such an anachronism – ***as Singapore was cautiously helping blaze a trail in the advancement of minority shareholder protections***.' [emphasis added]

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The common law/statutory derivative action

- Reasons for extension to listed companies:
  - Potentially frivolous litigation can be screened out via the requirement to obtain leave of court
  - It is more effective to empower shareholders in listed companies to take action rather than rely on monitoring by regulatory authorities
  - The option of selling shares on the stock market is not always satisfactory especially if the wrongdoers have caused a significant reduction in the share price
  - Making the statutory DA available to listed companies is in line with other leading jurisdictions (e.g. UK and Australia) and would help attract foreign investors who see this shareholder protection mechanism as the market standard

The common law/statutory derivative action

- Single or dual derivative action regime?
- Most leading jurisdictions have abolished the common law derivative action and migrated to a single statutory regime
  - Australia
    - s.236(3) of the Australian Corporations Act 2001: The right of a person at general law to bring, or intervene in, proceedings on behalf of a company is abolished.
  - New Zealand
    - S.165(6) of the NZ Companies Act 1993: Except as provided in this section, a shareholder is not entitled to bring or intervene in proceedings in the name of, or on behalf of, a company or a related company.

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The common law/statutory derivative action

- UK: Understood to have replaced the common law derivative action with a codified statutory derivative action regime under the UK Companies Act 2006, Part 11, Chapter 1
  - S.260(2) UK Companies Act 2006: "A derivative claim may only be brought— ***(a) under this Chapter***, or (b) in pursuance of an order of the court in proceedings under section 994" (emphasis added)
  - Legislative history: UK Law Commission (No. 246, 1997) citing commentary on the equivalent Canadian legislation
    'It would only ***lead to confusion*** to allow both common law and statutory actions. A more orderly development of the law would result from one point of access to a derivative action and would allow a body of experience and precedent to build up to guide shareholders.' (emphasis added)
  - (A small number of academic voices maintain that the UK CA 2006 does not expressly abolish the common law derivative action. See D. Lightman, 'Two Aspects of the Statutory Derivative Action' [2011] LMCLQ 142

The common law/statutory derivative action

- Singapore
  - With extension of statutory DA to listed companies (whether in Singapore or overseas), only foreign non-listed companies will have to rely exclusively on the common law DA
  - Examples from local case law:
    - *Ting Sing Ning v Ting Chek Swee* [2008] 1 SLR 197: HK incorporated company with principal place of business in Singapore - could only proceed via the common law DA and not the statutory DA
    - *Sinwa SS (HK) Co Ltd v Morten Innhaug* [2010] 4 SLR 1: BVI incorporated company could only proceed via the common law DA and not the statutory DA

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The common law/statutory derivative action

- Singapore
  - Should the common law DA be abolished and all actions (whether by foreign or Singapore companies) governed by the statutory regime?
  - Or is a dual regime with more onerous requirements to obtain leave for foreign companies justified?

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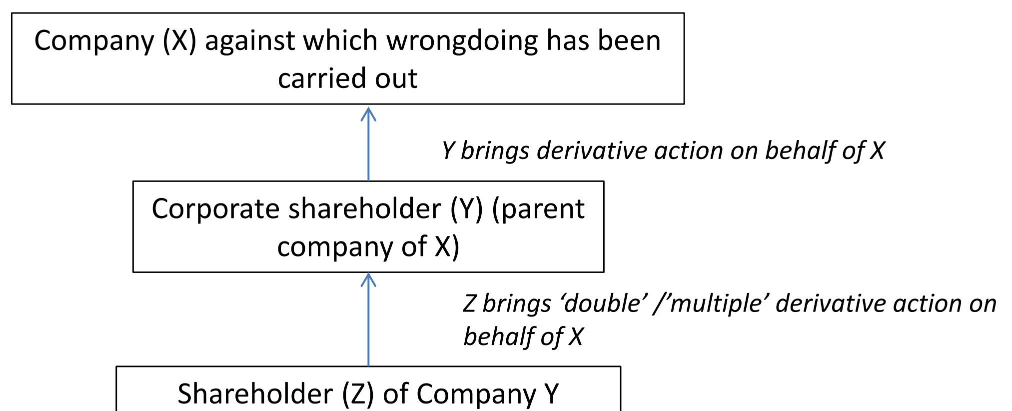
The common law/statutory derivative action

- Multiple Derivative Actions
  - Action by shareholder in a parent company in respect of a breach of duty owed to its subsidiary



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The common law/statutory derivative action

- *Waddington Ltd v Chan Chun Hoo Thomas* (Unreported, September 8, 2008) Court of Final Appeal of the HKSAR:
- Waddington (W) was minority shareholder in Playmates Ltd (P) holding 6.5% of shares
- P controlled various wholly-owned subsidiaries
- Chan (C) was a director of all the companies and it was alleged that the various subsidiary companies had entered into transactions for C's benefit
- Action was brought by W on behalf of P and/or P's subsidiaries against C for wrongs done to P's subsidiaries

The common law/statutory derivative action

- *Waddington Ltd v Chan Chun Hoo Thomas* (Unreported, September 8, 2008) Court of Final Appeal of the HKSAR:
- Held, as per Lord Millet (sitting as Non Permanent Judge of the Court of Final Appeal): A multiple derivative action could be brought by the minority shareholders (W) on behalf of the *subsidiary* itself

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The common law/statutory derivative action

- *Waddington Ltd v Chan Chun Hoo Thomas* (Unreported, September 8, 2008) Court of Final Appeal of the HKSAR

Respondent's (C) objections	Court's reasoning
A company was a separate legal person from its shareholders, and directors only owe fiduciary duties to the company and not its shareholders, let alone shareholders of its parent company.	Many Commonwealth jurisdictions (e.g. NZ, and Australia) have legislatively provided for multiple derivative actions without making significant changes to company law.

The common law/statutory derivative action

Respondent's (C) objections	Court's reasoning
A multiple DA is in truth 2 actions – 1) action by shareholder on behalf of parent company against subsidiary for <u>failure to sue the wrongdoers,</u> and 2) action by parent company on behalf of subsidiary against <u>wrongdoers.</u> 1) is not maintainable because a subsidiary owes no duty to its parent company to bring proceedings against wrongdoers. 2) is not maintainable because a parent company is in control of its subsidiary and does not need the intervention of its minority shareholders enable it to bring proceedings.	A multiple DA is not 2 (or more) derivative actions but a single action on behalf of the company in which the cause of action is vested. The only question is whether a shareholder of the parent company had **<u>standing</u>** to sue on behalf of the subsidiary company. Standing is determined by whether the shareholder had a legitimate interest in the relief claimed in the multiple derivative action. Since any depletion of a subsidiary's assets causes indirect loss to its parent company and shareholders, these shareholders had a legitimate interest to bring proceedings on behalf of the subsidiary.

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The common law/statutory derivative action

- *Universal Project Management Services Ltd v Fort Gilkicker* [2013] EWHC 348:

  – Affirming *Waddington*, the High Court of Justice (Chancery Division) held that multiple derivative actions are permissible at common law, even though s.260(1) of the UK Companies Act 2006 states that:

    " [A derivative action] may be brought by a ***member of a company***—

    (a) in respect of a cause of action vested in the company, and

    (b) seeking relief on behalf of the company."

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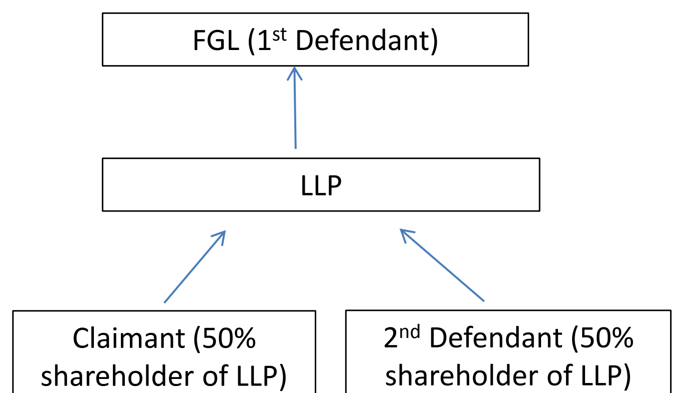
The common law/statutory derivative action

- *Universal Project Management Services Ltd v Fort Gilkicker* [2013] EWHC 348:

➢ Claimant alleged that 2nd Defendant as director of FGL (1st Defendant) misappropriated a corporate opportunity (to acquire real estate) for himself

➢ Cause of action was vested in FGL, which was unlikely to sue because LLP was its only shareholder and Claimant's representative and 2nd Defendant were its only directors



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The common law/statutory derivative action

- *Universal Project Management Services Ltd v Fort Gilkicker* [2013] EWHC 348:

  <u>Rationale of Multiple Derivative Action</u>

  – High Court held that the derivative action is merely a procedural device designed to prevent a wrong going without a remedy

  – Thus the law should extend *locus standi* to members of the wronged company's holding company, where the holding company is itself in the same wrongdoer control

  – At para 24: "*The would-be claimant is not exercising some right inherent in its membership, <u>but availing itself of the court's readiness to permit someone with a sufficient interest to sue as the company's representative claimant, for the benefit of all its stakeholders</u>".* (emphasis added)

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The common law/statutory derivative action

- *Universal Project Management Services Ltd v Fort Gilkicker* [2013] EWHC 348:

  <u>Is a Multiple Derivative Action precluded by the 2006 Companies Act?</u>

  – s.260(1) of the UK Companies Act 2006 states that:

    " [A derivative action] may be brought by a ***<u>member of a company</u>***—

    (a) in respect of a cause of action vested in the company, and

    (b) seeking relief on behalf of the company."

  – High Court held that while the "normal" derivative action at common law had been abolished by the Companies Act 2006, the 2006 Act did not do away with the multiple derivative action at common law

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The common law/statutory derivative action

- *Universal Project Management Services Ltd v Fort Gilkicker* [2013] EWHC 348:

  – At para 45: *"In 2006 Parliament identified the main version of that device (which procedurally facilitates persons with sufficient interests to litigate on behalf of a company)….[and] labelled it a "derivative claim" and enacted a comprehensive statutory code in relation to it. As a matter of language, section 260 applied Chapter 1 of Part 11 only to that part of the old common law device thus labelled,* ***leaving other instances of its application unaffected…Parliament did not expressly abolish the whole of the common law derivative action in relation to companies****, even though by implication from the comprehensiveness of the statutory code it did so in relation to derivative claims by members (as feined) of the wronged company."* (emphasis added)

The common law/statutory derivative action

- *Universal Project Management Services Ltd v Fort Gilkicker* [2013] EWHC 348:

  <u>*Does it matter whether the holding entity is a company?*</u>

  – Even though the holding entity of the wronged company was an LLP, the LLP's shareholders could bring a derivative action on behalf of the wronged company

  – At para 51: *"[O]nce it is recognised that the extension of* locus standi *beyond the immediate members of the wronged company is based upon the need to find a suitably interested claimant to pursue the company's claim when it is disabled from doing so,* ***the precise nature of the corporate body which owns the wronged company's shares is of no legal relevance****, provided that it is itself in wrongdoer control and has some members at least who are interested in seeing the wrong done to the company put right."* (emphasis added)

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The common law/statutory derivative action

- Comparison across jurisdictions

Jurisdiction	Allows multiple DAs under statutory regime?	Relevant legislation
Australia	Yes	s.236 of the Corporations Act 2001: Persons who may bring proceedings on behalf of the company include members of the company or a ***related body corporate***
New Zealand	Yes	s.165(1) of the New Zealand Companies Act 1993: Court may grant leave to 'bring proceedings in the name and on behalf of the company or ***any related company'***
UK	Available at common law	s.260(1) of the UK Companies Act 2006: A derivative action may be brought "by a ***member of a company***— (a) in respect of a cause of action vested in the company, and (b) seeking relief on behalf of the company."

References: A. Reisberg, 'Multiple derivative actions' LQR 2009, 125(Apr), S.H. Goo, 'Multiple derivative action and common law derivative action revisited: A tale of two jurisdictions' JCLS (April 2010), Vol.10

The common law/statutory derivative action

- **Singapore position**: S.216A appears broad enough to encompass multiple DAs

216A.—(1) In this section and section 216B —"company" means a company other than a company that is listed on the securities exchange in Singapore;

"complainant" means —

(*a*) any member of a company;

(*b*) the Minister, in the case of a declared company under Part IX; or

(c) any other person who, in the discretion of the Court, is a proper person to make an application under this section. (emphasis added)

- In any event, will the Singapore courts follow *Gilkicker* to hold that the multiple derivative action is available at common law?

The common law/statutory derivative action

- Meaning of "*good faith*" under S.216A of the Companies Act
  - *Ang Thiam Swee v Low Hian Chor* [2013] SGCA 11 (31 January 2013):
  - Ang and Low were minority shareholders of Company, with Gan as majority shareholder
  - Gan was convicted of making fraudulent tax claims on alleged expenses of the Company and was imprisoned and statutorily disqualified from directorship
  - Ang and Low engaged Stone Forest (a corporate advisory firm) to check the accounts of the Company, which showed that Gan had misappropriated an estimated S$5 million

The common law/statutory derivative action

- Meaning of "*good faith*" under S.216A of the Companies Act
  - Low sought leave under s.216A to bring suit in the Company's name against Ang for breach of director's duties, on the basis that the Stone Forest report also revealed that Ang had similarly misappropriated the Company's funds
  - The Court of Appeal explained the requirement of good faith as follows:
    - The Court ought to assess the motivations of the applicant
    - Insofar as they show that the applicant's judgment has been clouded by purely personal considerations, this suggests that the applicant does not honestly intend to serve the company's interests and may not be the proper party to represent the company's interests

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The common law/statutory derivative action

- Meaning of "*good faith*" under S.216A of the Companies Act
  - At para 13: *"[B]ad faith may be established where these **questionable motivations constitute a personal** **purpose which indicates that the company's interests will not be served**, ie, that s 216A(3)(c) (requirement that action must appear to be prima facie in the interests of the company) will not be satisfied… [G]ood faith is dependent less on the motives which trigger the application for leave to bring a statutory derivative action, and more on the **purpose of the proposed derivative action**, which must have an **obvious nexus with the company's benefit or interests**."* (emphasis added)

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The common law/statutory derivative action

- Meaning of "*good faith*" under S.216A of the Companies Act
  - A useful analogy for the test of *"good faith"* is the "*abuse of process"* test under O 18 r 19 of the Rules of Court, which allows an action brought for an ulterior or collateral purpose to be struck out
  - At para 30: *"Given that the statutory derivative action under s 216A of the Companies Act also relates to a similar exercise wherein the court has to evaluate the* bona fides *of the applicant based on affidavit evidence, the "abuse of process" test provides a useful standard by which to decide whether the applicant's collateral purpose amounts to bad faith".*

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The common law/statutory derivative action

- Meaning of "*good faith*" under S.216A of the Companies Act
  - On the facts of *Ang Thiam Swee*, the applicant had not acted in good faith because:
    - Low had brought the derivative action for a *"collateral purpose unconnected with doing justice to the company*", to "*even the score"* after discovering that Ang had been paid more director's fees
    - Low appeared to be taking a pre-emptive strike against Ang who was allegedly planning to kick out Low, re-employ Gan and facilitate a buyout of Gan's share by another company
    - Low was also motivated by a desire to secure sole control of the Company, given that if Ang could not repay the monies allegedly misappropriated by him, Low would assume *de facto* control of the Company

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The common law/statutory derivative action

- Meaning of "*good faith*" under S.216A of the Companies Act
  - Contrast *Ang Thiam Swee* with *Kwee Lee Fung Ivon v Gordon Lim Clinic Pte Ltd and another* [2013] SGHC 65 (20 March 2013):
    - Ex-Wife (Kwee) and Husband (Lim), both doctors, were sole shareholders of the Company
    - Kwee accused Lim of breaching his fiduciary duties to the company by operating a rival clinic in the company's premises without disclosing this to the company's board of directors
    - Kwee sought leave under s.216A to commence action on behalf of the company against Lim

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LITIGATION IN A CHANGING WORLD

The common law/statutory derivative action

- Meaning of "*good faith*" under S.216A of the Companies Act
  - Court found that Kwee was not driven by animosity between her and Lim (even though their relationship was undoubtedly hostile in the light of ongoing divorce proceedings)
  - Kwee asserted that Lim's actions reduced the company's revenue from $1,102,019 in the first 9 months of 2010 to $24,000 in the last quarter of 2010
  - Kwee was thus motivated by her own financial interest which coincided with the company's interest in recovering lost profits

The common law/statutory derivative action

- Meaning of "*good faith*" under S.216A of the Companies Act
  - Further, Kwee's application was not duplicitous in view of the forthcoming division of matrimonial assets
  - In fact, if leave was denied, Lim would be able to contend that the profits from his rival company are part of the assets in his name, which would give the court a misleading picture of the matrimonial assets in the hands of the parties (i.e. the impending divorce proceedings was a factor *for* rather than *against* the granting of leave)

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The oppression remedy

- Issues
  - The basis of an oppression claim: recent case law on ‘legitimate expectations arising from informal or implied understandings’
  - Examining the scope of oppression: capital issues and asset sales
  - Expansion of oppression remedy: can the company be granted relief in an action for oppression?

The oppression remedy: Overview

Companies Act (Cap. 50):

Personal remedies in cases of oppression or injustice

216.—(1) Any member or holder of a debenture of a company or, in the case of a declared company under Part IX, the Minister may apply to the Court for an order under this section on the ground —

(*a*) that the affairs of the company are being conducted or the powers of the directors are being exercised in ***a manner oppressive*** to one or more of the members or holders of debentures including himself or ***in disregard of his or their interests*** as members, shareholders or holders of debentures of the company; or

(*b*) that some act of the company has been done or is threatened or that some resolution of the members, holders of debentures or any class of them has been passed or is proposed which ***unfairly discriminates against*** or ***is otherwise prejudicial*** to one or more of the members or holders of debentures (including himself).

The oppression remedy

- Overall test of 'commercial unfairness'
- Singapore Court of Appeal in *Over & Over Ltd. V Bonvest Holdings Ltd* [2010] 2 SLR 776

"[R]ather than distinguishing one ground from the other in section 216, ***the four grounds set out therein ought to be looked at as a compound one****, **the purpose of which is to identify conduct which offends the standards of commercial fairness** and is deserving of intervention by the courts.* To this end, the combined language of section 216 is suggestive, descriptive and evocative in determining the scope of section 216…*rather than deciphering the precise nuance of each of the expressions 'oppression,' 'disregard of interests,' 'unfair discrimination' and 'prejudice,'* ***a compendious interpretative approach, with an emphasis on the rationale and purpose of section 216****, is hereby advocated [emphasis added by the Court of Appeal]"*

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The oppression remedy

- **The basis of an oppression claim: recent case law on 'legitimate expectations arising from informal or implied understandings'**
  - The starting point for determining commercial unfairness is the written agreement (M&A) between the members
  - However, unfairness can arise from conduct inconsistent with informal or implied understandings between the shareholders which formed the basis of their association but were not put into contractual form

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The oppression remedy

– Singapore Court of Appeal in *Over & Over Ltd. V Bonvest Holdings Ltd* [2010] 2 SLR 776

"[A] *majority shareholder may be within his strict legal rights but the manner in which he exploits his legal rights may call for the court's intervention. In particular, it is trite law that conduct can be unfair without even being unlawful*…**[T]hose who enter into a corporate structure often do not always spell out their rights and obligations in their entirety**, in part because they are unable to anticipate all the eventualities that may arise, but also because it would be disproportionately expensive and time-consuming to do so even if they could."

The oppression remedy

– Singapore Court of Appeal in *Over & Over Ltd. V Bonvest Holdings Ltd* [2010] 2 SLR 776

"Naturally, this problem is particularly acute in respect of those who **set up business with others essentially on the basis of mutual trust and confidence** – they would have operated on the belief that the majority would take their interests into account and that any such problems would be readily and civilly ironed out. Ironically, **often these understandings are not documented, let alone spelt out in legal terms, as it might be perceived that the very documentation of the understanding might betray a lack of trust**. This might seem naïve but unfortunately this behaviour is not infrequent, even today, in commercial dealings; relationships thin in words but thick in trust underpinned by the implicit belief that each will do right by the other without the need to spell out in embarrassing detail what is expected or needed." (emphasis added)

The oppression remedy

- Concept of "Legitimate Expectations"
  - *O'Neill and Another v. Phillips and Others* [1999] UKHL 24; [1999] 1 WLR 1092, as per Lord Hoffman:

"In *In re Saul D. Harrison & Sons Plc.* [1995] 1 B.C.L.C. 14, 19, **I used the term "legitimate expectation," borrowed from public law**, as a label for the "correlative right" to which a relationship between company members may give rise in a case when, on equitable principles, it would be regarded as unfair for a majority to exercise a power conferred upon them by the articles to the prejudice of another member.

The oppression remedy

"I gave as an example the standard case in which shareholders have entered into association upon the understanding that **each of them who has ventured his capital will also participate in the management** of the company…[An excluded] member could be said to have had a **"legitimate expectation" that he would be able to participate** in the management or withdraw from the company."

It was **probably a mistake** to use this term. The concept of a legitimate expectation **should not be allowed to lead a life of its own**, capable of giving rise to equitable restraints in circumstances to which the traditional equitable principles have no application. That is what seems to have happened in this case." (emphasis added)

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The oppression remedy

- *O'Neill and Another v. Phillips and Others* [1999] UKHL 24; [1999] 1 WLR 1092:
  - The House of Lords, overturning the Court of Appeal's decision held *inter alia* that a minority shareholder had no right to allotment of more shares, even though there were draft agreements to that effect with the majority shareholder (but made subject to formal agreements being drawn up by professional advisers and signed)

The oppression remedy

- *O'Neill and Another v. Phillips and Others* [1999] UKHL 24; [1999] 1 WLR 1092:

  "[T]he Court of Appeal said that Mr. O'Neill had a legitimate expectation of being allotted more shares... **No doubt he did have such an expectation** before 4 November and **no doubt it was legitimate, or reasonable**, in the sense that it reasonably appeared likely to happen. Mr. Phillips had **agreed in principle, subject to the execution of a suitable document**. But this is where I think that the Court of Appeal **may have been misled** by the expression "legitimate expectation." The real question is whether in fairness or equity Mr. O'Neill had a right to the shares." (emphasis added)

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The oppression remedy

- *O'Neill and Another v. Phillips and Others* [1999] UKHL 24; [1999] 1 WLR 1092:

  "On this point, one runs up against what seems to me the insuperable obstacle of the judge's finding that Mr. Phillips never agreed to give them. **He made no promise on the point.** From which it seems to me to follow that there is **no basis, consistent with established principles of equity**, for a court to hold that Mr. Phillips was behaving unfairly in withdrawing from the negotiation. This would not be restraining the exercise of legal rights. **It would be imposing upon Mr. Phillips an obligation to which he never agreed**. Where, as here, parties enter into negotiations with a view to a transfer of shares **on professional advice** and **subject to a condition that they are not to be bound** until a formal document has been executed, I do not think it is possible to say that an obligation has arisen in fairness or equity at an earlier stage."

The oppression remedy

- Criticism of *O'Neill and Another v. Phillips* by New Zealand Courts:

  – In *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd* [2005] 2 NZLR 328*,* the NZ Court of Appeal declined to follow the more restrictive interpretation of "legitimate expectations in *O'Neill,* citing policy reasons that:

    - Senior executives and directors might avoid smaller companies for fear of being "locked in"
    - The *O'Neill* approach narrows what is "fair" down to pre-existing formal arrangements
    - The more restrictive approach in *O'Neill* has not solved the problem of excessive, time-consuming and costly litigation in the UK

  – (On the facts, the Court of Appeal held that the minority shareholders had no legitimate expectation of being involved in management, given that the company in question was a large publicly listed company.)

The oppression remedy

- Criticism of *O'Neill and Another v. Phillips* by New Zealand Courts:
  - *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd* [2005] 2 NZLR 328*:*

    "[W]e are not persuaded that the judicial approach to this important provision in New Zealand company law should be judicially recast in a more restrictive mode at this time…. Relief can be given **even if the conduct complained of does not involve a want of good faith or a lack of probity**. The fact that all members are treated uniformly as members will not necessarily make conduct fair. The **reasonable expectations** of members are distinctly relevant - though this factor is not in and of itself necessarily determinative - and those expectations are not necessarily restricted to purely "internal", or "formal" expectations. There are **no fixed categories of cases** to which s174 apply." (emphasis added)
  - *Latimer* has been cited and affirmed in later NZ decisions, e.g. *Dunning v Chabro Holdings Ltd* (2007) 10 NZCLC 264

The oppression remedy

- Singapore courts' approach to *O'Neill and Another v. Phillips*:
  - In *Eng Gee Seng v Quek Choon Teck and others* [2009] SGHC 205, the High Court cited *O'Neill* with approval:
  - *"I am of the view that the English court's transposition of legal principles…in cases such as* Re A Company, Re Saul D Harrison & Sons plc *and* O'Neill*, was right. This approach is, and ought to be, part of our law…The principles of fairness must be applied judicially and based upon "rational principles"…**These "rational principles" can be found in the law of contract as complemented by the principles of equity**…In the case of an **ordinary** company, prima facie, the company's **formal documents lay down the basis of the association exhaustively**. However, there can also exist agreements, understandings or promises as between members of an association, which are not in those formal documents, but which may give rise to **reasonable or legitimate expectations** an the part of minority members. The onus will then be on the minority members to show that such informal or implied understandings, giving rise to certain expectations, exist."* (emphasis added)

The oppression remedy

- Singapore courts tend to use the structure of the company in question (i.e. whether it is a **quasi-partnership** with relationships of **mutual confidence** between shareholders, an agreement as to **shareholder participation in management** and/or a **restriction on share transfer**) as a key guiding factor in determining whether there are any "legitimate expectations" beyond the scope of written agreements:

- *Eng Gee Seng*: *"Quasi-partnerships, however, are formed based on mutual trust and confidence…Accordingly, a higher standard of governance is expected of them as compared with controllers of ordinary companies. Therefore, there should be **greater leeway for finding informal understandings and expectations.**"* (emphasis added)

- *Over & Over Ltd: "[C]ourts must take into account both the legal rights and legitimate expectations of members. Whilst these legal rights and expectations are usually enshrined in the company's constitution in a majority of cases, a **special class of quasi-partnership companies form an exception to this rule**".* (emphasis added)

The oppression remedy

- <u>Informal understanding must be shared by all the shareholders and parties must have explicitly communicated the understanding to each other</u>

- *Thio Keng Poon v Thio Syn Pyn* [2010] 3 SLR 143 (Court of Appeal)

  - Appellant who alleged oppression was the founder, director, managing director and chairman of a number of group companies

  - Appellant had transferred his shares in the group companies to his wife and children for no consideration over several years, resulting in his wife and children holding a majority of shares in the group companies

  - Based on an external audit which revealed that the Appellant had been double-claiming for business-related travel expenses, Appellant's oldest son called for a board meeting at which the Appellant was removed from all his management positions

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– *Thio Keng Poon v Thio Syn Pyn* [2010] 3 SLR 143 (Court of Appeal)

- Appellant challenged his removal on the basis of s.216, claiming that the share transfers to his family members was undertaken based on the informal understanding that he would retain his management positions (the 'Understanding')

- Court of Appeal, agreeing with the High Court, dismissed the claim:
  – The Understanding <u>did not exist</u> because it was <u>never discussed</u> with any of the Appellant's children
  – The understanding was <u>unspoken</u> and there was no way that his family members could have known about it
  – Thus, <u>there could not have been any legitimate expectations</u> arising from the (non-existent) terms of the Understanding

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The oppression remedy

- Dan W. Puchniak & Tan Cheng Han, *Company Law* in *<u>Singapore Academy of Law Annual Review</u>* (2011), 206-207

Agreeing that legitimate expectations cannot be founded on unilateral beliefs:

"We respectfully submit that the Court of Appeal's decision to limit the scope of legitimate expectations to **understandings between all of the shareholders** in a company makes sense. **Expanding the scope of legitimate expectations to include the unilateral beliefs of individual shareholders would open a Pandora's Box for the oppression remedy in Singapore – even if those unilateral beliefs were reasonable**. Such an expansion would allow an individual shareholder to use s 216 to effectively enforce "secretly held terms" on all other shareholders (*ie*, terms which the other shareholders neither agreed to nor were unaware of). This would introduce a significant amount of uncertainty into shareholder relationships in Singapore which would discourage equity investment."

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The oppression remedy

- Dan W. Puchniak & Tan Cheng Han, *Company Law* in Singapore Academy of Law Annual Review (2011), 206-207

But querying whether there was a "general unspoken understanding" on the facts:

"Our strong support for the Court of Appeal's clear limitation on s 216 claims does, however, give rise to a query about how the limitation was specifically applied in this case...We submit that merely because a shareholder's understanding is "unspoken" does not axiomatically mean that it cannot be known to (or shared by) the other shareholders. In fact, **considering business and cultural norms in Singapore**, it seems plausible that when a founding patriarch gifts his shares to his family, out of respect for the patriarch, there is an understanding that he will maintain a management position in the **company…If such a general unspoken understanding indeed exists in Singapore, then there may have been a legitimate expectation that the appellant not be removed from his management positions**." (emphasis added)

The oppression remedy

- Informal understanding can *restrict* rather than *expand* the scope of minority protection
- *Tan Yong San v Neo Kok Eng and others* [2011] SGHC 30 (not appealed)
  - Plaintiff was 0.89% shareholder and director whose sole responsibility was to periodically sign documents
  - Defendant, the 99.11% shareholder, removed the Plaintiff from his directorship position when the Defendant fell out with the Plaintiff's brother-in-law, who was at that time the Managing Director of a related company
  - Plaintiff alleged oppression on basis that:
    - 1) Defendant had breached informal understanding that Defendant would receive director's remuneration in consideration for the liabilities he assumed as guarantor for company
    - 2) Defendant had misappropriated and misused company funds (e.g. pocketing commissions which the company's foreign workers were obliged to pay the company

The oppression remedy

- *Tan Yong San v Neo Kok Eng and others* [2011] SGHC 30
  - High Court held:
  - Oppression was made out on the ground of wrongful ouster of the Plaintiff as a director
  - However, no oppression on the basis of misusing of company funds because there was an informal understanding that the Defendant could run the company as he saw fit

"While such informal or implied understandings are usually relied on to subject the actions of the majority to greater scrutiny, ***they can conversely also be used to prevent the minority from complaining*** about matters in which they had given the majority *carte blanche*. The present case is one such example. Since the understanding between Tan and Neo was that Neo could run the Chip Hup Group as his personal fiefdom, Tan cannot be heard to complain now that Neo had been manipulating CHH and its subsidiaries for his own personal gain." (emphasis added)

The oppression remedy

- **Examining the scope of oppression**

- Evidently 'oppressive' scenarios: exclusion from management, inadequate dividends to minority shareholders, excessive remuneration to directors/majority shareholders, direct expropriation of minority shares or variation of class rights

- Less clear-cut: Rights issues and asset sales (transactions which at first blush may appear to have an equal impact on all shareholders and commercially justified)

The oppression remedy

- **Examining the scope of oppression: Dilution of minority shareholder's stake through capital issues?**
  - R. Hollington QC, *Shareholders' Rights* (Sweet & Maxwell: 2010) at 260

    "A rights issue is a common means of raising capital from shareholders on an equal basis without diluting any shareholder's interest in the company, but it has the obvious potential, in the hands of an unscrupulous majority, of putting pressure on the minority with the prospect of dilution…of their interest in the event of non-participation."

The oppression remedy

Case	**Whether rights issue constituted oppression – majority shareholder's knowledge of minority shareholder's financial circumstances is a key factor**
Re a Company No.002612 of 1984 (1986) 2 B.C.C. 99453	Majority shareholder attempted to procure a rights issue with the dominant purpose of reducing the minority shareholder's 33.33% stake in the company to less than 1%, knowing that the minority shareholder was financially constrained and would not be able to take up his due proportion of the £99,000 rights issue. Vinelott J. held that: "It seemed to me for a long time it could not be prejudicial ever to have a rights issue pro rata to all members at a moderate price, because no change in their interest was thereby effected... However, I have come to the conclusion that it is arguable…that it may be, although not an alteration of their interest yet unfairly prejudicial to their interest, ***if it could be shown, for example, that it was known that although the offer would be pro rata yet the member would be unable by reason of his own circumstances to take it up, and that knowledge was a factor leading to the making of an offer which was in truth illusory because it could never be accepted.*** (emphasis added)

The oppression remedy

Case	Whether rights issue constituted oppression – unfair prejudice can exist even where share capital is increased without shares being allotted yet
Re Sunrise Radio Limited [2009] EWHC 2893 (Ch)	Majority shareholder increased share capital as a preliminary step to dilution of the minority shareholder's 8.33% stake. The increase was effected deceptively, after she was untruthfully told that the EGM to consider the resolution to increase the share capital would not take place. Further, at the EGM, the directors were authorized to disapply pre-emption rights in the company's articles of association. The court held that: "In my judgment, the circumstances of the 2007 share increase were unfairly prejudicial to Ms Kohli. ***The fact that no shares have yet been allotted is irrelevant.*** The consequence of the way in which the increase was carried out, and pre-emption rights disapplied, is that such chance as there was of restoring in Ms Kohli any semblance of the necessary minimum of trust in the integrity of the board (and the majority shareholders) has been fatally undermined. Ms Kohli is entitled to regard her continued position as shareholder intolerable for this additional reason***."*** (emphasis added)

The oppression remedy

Case	Whether unilateral allotment constituted oppression – clearly prejudicial where there is no commercial justification for unilateral allotment
Dalby v Bodilly [2005] BCC 627	The petitioner and the first respondent each acquired a 50% shareholding of 50 shares each in the company. After the relationship between the parties broke down, the respondent allotted to himself the remaining 900 shares in the company's authorised share capital, thus diluting D's 50% interest in the company to 5%. The court held that there was no commercial justification for the allotment of the shares: "I am quite unable to see how allotting these further shares can in any sense operate as some kind of protection of the company. ***When I enquired of Mr Hood, who appears for Mr Bodilly, what exactly "protection of the company" meant, he answered in effect, "Voting control"***...In my judgment Mr Bodilly's action in causing, in flagrant breach of his fiduciary duty to the company, the allotment and issue to himself, nil-paid, of these additional 900 shares unquestionably amounted to unfairly prejudicial conduct." (emphasis added)

The oppression remedy

Case	**Whether allotment of shares to majority shareholder and other parties constituted oppression – unfair prejudice can be found even where there appears to be commercial justification for allotment**
Re Zetnet Ltd [2011] EWHC 1518 (Ch)	Majority shareholder procured allotment whereby minority shareholder's interest in company was reduced from 50% to 0.1%. Majority shareholder argued that the reason for the allotment was that there was a <u>*cash flow crisis*</u> in the company, and further that dilution was justified because the <u>*minority shareholder has caused the cash flow crisis*</u> (by demanding payment owed by the company to the minority shareholder's company). The court held that: "In the present case, objectively considered, the dilution of Mr Harris's interest from 50% to 0.1% was unfair. ***It cannot be justified even against the background of the difficulties which Mr Harris was causing the company.***" (emphasis added)

The oppression remedy

- Position in Singapore?

- M. Chew, *Minority Shareholders' Rights and Remedies* (LexisNexis:2007) at 201

  "It is clear that allegations of improper use of majority voting power to effect an issue of shares to dilute shareholdings may be addressed under section 216 of the Companies Act. In deciding whether use of voting power was oppressive or commercially unfair, section 216 empowers the court to look into all the facts and circumstances of the case, in order to ascertain the expectations of the parties *inter se*."

The oppression remedy

Case	Whether rights issue to apparently pay back a loan ahead of schedule amounted to oppression
Over & Over Ltd v Bonvests Holdings Ltd and anor [2010] SGCA 7	Majority shareholder (70%) pushed through rights issue to pay back a loan one year in advance of the deadline, despite minority shareholder's objection. The Singapore Court of Appeal held that the minority shareholder had plainly suffered prejudice. At [122], [127] and [130]: "[T]he lack of urgency for new funds – especially when contrasted with the speed at which the issue of new shares is carried out – is often a good indication of what the true objective of the rights issue is…The raising of capital for a company is always a serious matter…it could have consequences that might affect the proportion of shareholdings in a quasi-partnership type company***. This entirely unnecessary haste in deciding on and muscling through the Rights Issue, coupled with the complete absence of any commercial justification…is a testament to just how capricious the whole process was. It smacked of a abuse of rights.***" (emphasis added)

The oppression remedy

- **Examining the scope of oppression: Asset sales**

  – David Chivers QC, *The Law of Majority Shareholder Power: Use and Abuse* (Oxford:2008)

    " A…way in which majority shareholders in a company (A) can remove minorities is by using their control of A's board to cause A to sell its business and undertaking to another company (B) which is wholly owned by them. Once the sale is completed, the majority shareholders are free to continue operating A's business through the medium of their wholly owned company, B, and minority shareholders in A are left holding shares in a cash shell."

The oppression remedy

– Basis of claim of 'unfairness':
  - Understanding between members that there would be no sale of the company's undertaking to the majority

    David Chivers QC, *The Law of Majority Shareholder Power: Use and Abuse* (Oxford:2008)

    " In an appropriate case…a minority shareholder could argue that an agreement or understanding existed between the members that the directors' power under the company's objects clause to sell the company's business and undertaking would not be exercised in order to effect a sale to the majority."

  - Alternatively, breach of directors' fiduciary duties not to place themselves in a position of conflict or to act in the best interests of the company (by procuring a sale to the majority shareholders at an undervalue/not the best possible price)

The oppression remedy

– Petitioner must demonstrate prejudice:
  - *Rock Nominees Ltd v RCO (Holdings) plc (in liquidation) and Others* [2003] 2 BCLC 493 (Ch), [2004] 1 BCLC 439 (CA)
  - Takeover context
  - Bidder acquired 96% of shares in target, but not sufficient to enable it to use the compulsory squeeze-out mechanism under ss.974-991 of the UK Companies Act 1985.
  - To remove the petitioner (the minority shareholder), the bidder procured the target company to sell its only substantial asset (its operating subsidiary) to the bidder
  - The price paid by the bidder was equivalent to the price offered by the bidder under the terms of the public offer for shares in the target (i.e. not at undervalue)
  - The petitioner alleged that the sale constituted unfair prejudice

The oppression remedy

- UK Court of Appeal, agreeing with the trial court, held that the petitioner had not suffered any prejudice because **the sale of the target's subsidiary had not taken place at an undervalue**

- Furthermore, the **minority shareholder had engaged in 'greenmail'** – buying shares in the target company after the bidder had announced its bid for the purpose of preventing the bidder from acquiring complete control of the target and to force the bidder to pay a higher price for its shares.

- Thus, the court did not find that the petitioner had been unfairly prejudiced.

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The oppression remedy

- **Other relevant factors militating against a finding of oppression (not discussed in *Rock Nominees*)** (David Chivers QC, *The Law of Majority Shareholder Power: Use and Abuse* (Oxford:2008)):

  – Loss of profit opportunities:

  *"[T]here is a respectable argument that the prejudice suffered by a minority shareholder is the **loss of exposure to the risk and rewards** associated with the company's business…the minority shareholder can argue that such a sale prejudices him, because it d**enies him the chance to share in future profits** generated by the company's business."* (emphasis added)

  – Viability of company's business:

  If the company's business is loss-making, the sale of the company's business may be presented as a form of corporate rescue.

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The oppression remedy

- **Expansion of oppression remedy to allow for corporate damages: can the company be granted relief in an action for oppression?**

- Dan. Puchniak and Wee Meng Seng, 'Derivative actions in Singapore: mundanely non-Asian, intriguingly non-American and at the forefront of the Commonwealth' in *The Derivative Action in Asia* (Cambridge:2012)

  "In reality, the grievances of a minority shareholder may reveal that he or she has been unfairly prejudiced by the majority *and* the directors have also committed wrongs against the company. To adhere to doctrinal purity here would mean the minority shareholder having to bring a section 216 action and a section 216A action to vindicate his or her personal rights and the rights of the company, respectively. This is not always desirable and can cause hardship, delay and unnecessary costs. ***The issue thus arises as to the extent to which section 216 may be used to outflank the rule in*** **Foss** ***and obtain redress for the company.*** (emphasis added)

The oppression remedy

- UK's position: More recently began to allow corporate relief in a personal action

  - Previously: In *Re Charnley Davies Ltd (no. 2)* [1990] BCLC 760, Millet J held that while the same acts might be grounds for both a derivative action and unfair prejudice remedy, the nature of the complaint and the remedy sought would determine which proceeding was appropriate.

  - Currently: In *Bhullar v Bhullar* [2003] EWCA Civ 424, the UK Court of Appeal affirmed the trial court's granting of a corporate remedy in a case where the minority shareholders only asked for personal relief and permission to bring a derivative action
    - Defendant-Directors were ordered to transfer a piece of property which they had diverted to themselves back to the company at the price which was paid for it

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The oppression remedy

- Singapore's position: Allowed corporate relief in a personal action much earlier than UK
  - *Kumagai Gumi Co. Ltd. V Zenecon Pte Ltd* [1995] SGCA 52: Singapore Court of Appeal affirmed trial judge's order that company should be compensated in a s.216 claim
    - *Inter alia,* that the Defendant-oppressor pay an amount to the Company representing the fair market rental for the use of various items of machinery and equipment used by the Defendant's business without payment to the Company
  - *Low Peng Boon v Low Janie* [1999] SGCA 8: Singapore Court of Appeal ordered wrongdoing director to make restitution to company of unauthorized payments (travelling expenses and bonuses) in a s.216 claim.
    - At para 55: "*Section 216(2)…provides [that] the Court may, with a view to bringing to an end or remedying the matters complained of, make such order as it thinks fit…The court has an unfettered discretion to make such order as it thinks most appropriate. Each case has to be considered on its own merits.*"

The oppression remedy

- Singapore's position: Allowed corporate relief in a personal action much earlier than UK
  - Dan. Puchniak and Wee Meng Seng, 'Derivative actions in Singapore: mundanely non-Asian, intriguingly non-American and at the forefront of the Commonwealth' in *The Derivative Action in Asia* (Cambridge:2012)

"Compared to English courts, Singapore courts have been more ***pragmatic and facilitative of minority shareholder rights***. They have not felt constrained by doctrinal considerations from granting corporate relief in section 216 cases." (emphasis added)

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A JOINT CONFERENCE OF THE SINGAPORE ACADEMY OF LAW AND THE CHANCERY BAR OF ENGLAND AND WALES

25 & 26 April 2013
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Singapore

DERIVATIVE ACTIONS AND MINORITY OPPRESSION

Prof. Tan Cheng Han, SC & Thio Shen Yi, SC

TSMP Law Corporation

Finance, Property and Business Litigation in a Changing World

Concurrent Session 3B: Bank-Customer Litigation

Chairperson and Speaker

Mr Richard Millett QC, *Essex Court Chambers*

Speakers

Mr Ang Cheng Hock SC, *Allen & Gledhill LLP*

Mr Kannan Ramesh SC, *Tan Kok Quan Partnership*

Mr Nicholas Lavender QC, *Serle Court*

Hot Button Issues in Private Banking Litigation

Kannan Ramesh SC

Claims against a Private Bank

- Since the global financial crisis in 2008, there has been a proliferation of mis-selling claims against private banks.
- A common theme in such claims is the allegation of breaches of contractual and tortious duties of care to advise on the suitability of investment products offered by the private bank for investment.

Obligation to Provide Advice

- An obligation to advise a private banking client can arise in contract but:
  - a contractual duty to advise is difficult to establish in the absence of an express term. This is because it is difficult to imply such a term; and
  - private banking contracts may also contain entire agreement clauses which exclude any collateral agreements.

Kannan Ramesh SC

Obligation to Provide Advice

- A duty to advise can also arise in tort, but the approach to finding such a duty differs under English and Singapore law.
- Gloster J in *JP Morgan Chase Bank v Springwell Navigation Corporation* [2008] EWHC 1186 (Comm) also enunciated a separate tortious low level duty of care.

Kannan Ramesh SC

Test for Duty of Care

- The approach to establishing a duty of care is different in Singapore and England:
  - To determine whether there is a duty of care, Singapore applies the *Spandeck* two-stage test comprising first, proximity, and second, policy considerations, which are together preceded by the threshold question of factual foreseeability.
  - In English law, *Springwell* (HC) sets out indicia of a duty of care to advise, which are considered a more useful guide than "*high abstractions*".
  - These *Springwell* indicia can fit into the *Spandeck* framework (*Go Dante Yap* at [29]).

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Contractual Estoppel

- The doctrine of contractual estoppel is very often an obstacle to claims against private banks.
- Contractual estoppel arises when parties agree that "*a particular state of affairs*" forms the basis on which they are contracting. It precludes any assertion of facts inconsistent with that agreement, regardless of whether the agreed state of affairs is true (*Cassa di Risparmio della Repubblica di San Marino SpA v Barclays Bank Plc* [2011] EWHC 484 at [488]).
- There are 3 common types of contractual estoppel clauses that operate as obstacles to claims by clients:
  - non-reliance clauses;
  - representations as to sophistication; and
  - no advice clauses.

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Contractual Estoppel Negates Advisory Duty

- Contractual estoppel is a significant barrier to finding any general advisory duty (whether arising in contract or in tort), even where a relationship is on its facts advisory as:
  - express contractual estoppel clauses are inconsistent with any implied term imposing an advisory duty;
  - they estop a client from asserting reliance on advice. This hinders the establishment of a duty of care under both the Singapore and English law approaches; and
  - they further preclude a private client from establishing a chain of causation between any breach and his loss.

Contractual Estoppel in Singapore

- The doctrine has been applied in Singapore (*Orient Centre Investments Ltd and another v Société Générale* [2007] 3 SLR(R) 566).
- More recently, however, in *Deutsche Bank v Chang* [2012] SGHC 248 at [138], following Chan CJ's dictum in *Als Memasa and another v UBS AG* [2012] SGCA 43, Pillai J did not apply the contractual estoppel doctrine.
- Hong Kong has adopted the strict English position on contractual estoppel (*DBS Bank (Hong Kong) Ltd v San-Hot HK Industrial Company Ltd* HCA 2279/2008).

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Contractual Estoppel in Singapore

- Chan CJ said at [29] of *Als Memasa*:

  "However, in the light of the many allegations made against many financial institutions for "mis-selling" complex financial products to linguistically and financially illiterate and unwary customers during the financial crisis in 2008, **it may be desirable for the courts to reconsider whether financial institutions should be accorded full immunity for such "misconduct" by relying on non-reliance clauses which unsophisticated customers might have been induced or persuaded to sign without truly understanding their potential legal effect on any form of misconduct or negligence on the part of the relevant officers in relation to the investment recommended by them.**"

Deutsche Bank v Chang

- Pillai J was of the view that the Court of Appeal in *Als Memasa* "*appears to have retreated somewhat*" from *Orient*, at least for unsophisticated clients (at [136]).
- As a result, he was "*extremely hesitant*" to apply the doctrine of contractual estoppel as developed in *Peekay* (at [138]), and distinguished *Orient* on the basis that the bank knew that Dr Chang was financially inexperienced, the bank had the expertise and it undertook to advise Dr Chang.
- This case may therefore have created an exception to the strict operation of contractual estoppel with respect to unsophisticated clients.

Deutsche Bank v Chang

- On the separate doctrine of evidential estoppel, Pillai J held that no estoppel arose as the 2nd element of the test in *Lowe v Lombank* [1960] 1 WLR 196 was not met (at [137]). The elements are that:
  - the maker of the statement intended it to be taken as true and relied upon;
  - the other party believed it to be true; and
  - the other party in fact relied upon it.
- A possible reading of Pillai J's decision in that where the exception applies, only evidential estoppel operates.

Deutsche Bank v Chang

- Pillai J further found that even if contractual estoppel operated in Singapore, no "*clear intention for it to operate*" was established on the evidence (at [138]).
- This may relate to his earlier finding at [39] – [42] in relation to the interpretation of the Service Agreement.
- *Chang* is on appeal to the Court of Appeal.

Low Level Duty of Care

- The low level duty of care is owed by a salesperson.
- It comprises 2 limbs (*Springwell* (HC) at [108]):
  - a duty not to make negligent misstatements; and
  - a duty to use reasonable care not to recommend a highly risky investment without pointing out that it was such.

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Low Level Duty of Care

- Gloster J in *Springwell* (HC) held at [108]:

  "It may well be that, theoretically, in such circumstances, a low level duty of care would arise on the part of the salesman not to make any negligent misstatements, or even to use reasonable care not to recommend a highly risky investment without pointing out that it was such, but a low level duty along those lines is worlds away from the wide duty of care that was pleaded or relied upon as having arisen at this early stage."

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Low Level Duty of Care

- Aikens LJ in *Springwell* (CA) held at [123]:

  "As for the claim against CMIL (as employer of JA) based on alleged negligent misstatement, I would be prepared to accept as correct the judge's tentative conclusion that there would be a "low level" duty of care on the part of a salesman (such as JA) not to make any negligent misstatements; and to use reasonable care not to recommend a highly risky investment without pointing out that it was such."

Low Level Duty of Care

- No Singapore case has considered the *Springwell* low level duty of care.
- The 1st limb of the low level duty is nothing more than a reiteration of *Hedley Byrne*.
- The 2nd limb is new and will need elucidation:
  - when is an investment highly risky?
  - what constitutes pointing out that an investment is highly risky?
  - does the standard of care change over time (e.g. as a client enters into the same transaction 10 successive times)?

Low Level Duty of Care

- It is not clear how the courts will determine whether an investment product is highly risky.
- The following factors may be relevant:
  - the potential downside of the product;
  - the prevailing economic context (including uncertainty in the market); and
  - the client's sophistication.

Low Level Duty of Care

- Practically, other relevant factors include (i) the client's current investments and (ii) the client's ability to meet margin calls.
- To what extent would a consideration of the above factors elevate the duty beyond a "low level" one?
- Or are we reading too much into Gloster J's use of the term "low level duty"?

Low Level Duty v Contractual Estoppel

- The HC and CA *Springwell* decisions do not consider the effect of contractual estoppel on the low level duty.
- Does contractual estoppel prevent even the low level duty of care from arising?
  - Conceptually, a non-reliance clause could estop any claim under the 1st limb, since a claim under *Hedley Byrne* requires reliance. This could also be the effect on the 2nd limb.
  - In any event, such clauses may affect the ability of a claimant to establish the causative link between breach and loss.

Addressing Contractual Estoppel

- Arguments based on privity of contract
- Arguments based on a misrepresentation as to the effect of a contract (*Curtis* and *Waterhouse*)
- Arguments based on UCTA / section 3 of the Misrepresentation Act

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FINANCE, PROPERTY AND BUSINESS LITIGATION IN A CHANGING WORLD

Privity

- A private client may have separate contracts with the private bank and other transactional counterparties within the same banking group.
- While it is common for contractual estoppel clauses to be found in agreements with transactional counterparties e.g. the ISDA Master Agreement, the same clauses may not be present in a private banking agreement.
- In such cases, it is arguable that the private bank cannot rely on the terms of the contract(s) to which it is not privy.

Privity – Potential Difficulties

- However, the private bank may seek to rely on those terms through the operation of the Contracts (Rights of Third Parties) Act i.e. where the counterparty contract(s) purports to confer a benefit on the private bank.
- If the private banking client enters into a web of separate contracts with entities within the same group, the court may look at the close commercial connection between the entities and draw a broad evidentiary conclusion from the terms even if the terms belong to a different relationship (*Springwell* (HC) at [499]).

Misrepresentation as to Effect

- As observed in *Als Memasa*, there are many allegations made against many financial institutions for "mis-selling" complex financial products to linguistically and financially illiterate and unwary customers.
- In Asia, private banking clients often expect advice from their private bankers. They typically rely on their private bankers to explain the contractual documents to them.
- What is the effect of a private banker purporting to explain contractual documents without explaining the effect of the contractual estoppel clauses? Does the principle in *Curtis* and *Waterhouse* extend to this situation?

Misrepresentation as to Effect

- Moore-Bick LJ in *Peekay Intermark Limited v ANZ* [2006] EWCA Civ 386 held at [44]:

  "From time to time one party to a contract misrepresents to the other the content or effect of the document which is intended to embody their agreement. In such cases it has been held that the party making the misrepresentation is prevented from enforcing the contract in accordance with its terms …"

Misrepresentation as to Effect

- Moore-Bick LJ elaborated:

  "… An example is to be found in the well-known case of *Curtis v The Chemical Cleaning and Dyeing Co Ltd* [1951] 1 K.B. 805 in which the defendant was prevented from relying on a general exemption clause on the back of the cleaning ticket after its shop assistant had induced the customer to sign it by telling her that it excluded liability only for damage to beads or sequins …"

Misrepresentation as to Effect

- Moore-Bick LJ further held at [44]:

  "… The principle was applied by Woolf L.J. in *Lloyds Bank Plc v Waterhouse* [1993] 2 F.L.R. 97 in which the defendant was induced to sign a guarantee of a loan to his son by the bank's misrepresentation of its scope and content. He held that bank was unable to enforce the guarantee in accordance with its terms."

UCTA

- The last bastion against contractual estoppel clauses is UCTA – that the clauses are unreasonable.
- However, 2 issues may present a problem to the application of UCTA:
  - Singapore law (or English law) must govern the contract apart from any express choice of law (see section 27 UCTA); and
  - the contractual estoppel clauses must be considered exemption clauses and not "basis" clauses.

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UCTA – Section 27(1)

- Section 27(1) provides:

  "**Choice of law clauses**
  27.—(1) Where the proper law of a contract is the law of Singapore only by choice of the parties (and apart from that choice would be the law of some country outside Singapore) sections 2 to 7 do not operate as part of the proper law."

- What if the objective proper law of the contract is not Singapore law? There would then be no UCTA protection for the private client.

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UCTA – "Basis" Clause?

- In *Springwell* (HC) (at [601] – [602]), Gloster J drew a distinction between clauses that define the basis upon which a bank renders services, and clauses which exclude liability. Only the latter fall within the scope of UCTA.
- *Springwell* (CA) accepted this distinction.
- It also adopted Clarke J's test in *Raiffeisen* [2010] EWHC 1392 (Comm) to distinguish between the 2 types of clauses.

UCTA – "Basis" Clause?

- Clarke J in *Raiffeisen* expressed the view (at [314]) that the "*key question*" is "*whether the clause attempts to rewrite history or parts company with reality*", using the following example at [315]:

  "… to tell the man in the street that the car you are selling him is perfect and then agree that the basis of your contract is that no representations have been made or relied on, may be nothing more than an attempt retrospectively to alter the character and effect of what has gone before and in substance be an attempt to exclude or restrict liability."

UCTA – "Basis" Clause?

- It remains to be seen whether and how the *Raiffeisen* test will be applied in Singapore in the light of the sentiments expressed in *Als Memasa*.
- It may also be difficult to argue that a private banking client should be treated like the man on the street.

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Private Banking Code

- In 2011, MAS promulgated the Private Banking Code of Conduct in consultation with the private banking industry, which "*provide[s] guidance on standards of good practice*".
- The Code itself is not legally binding.
- If a duty of care to advise can be established, the Code can inform the standard of care required of the bank.

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Hot Button Issues in Private Banking Litigation

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NON-RELIANCE CLAUSES AND THE BANK/CUSTOMER RELATIONSHIP

Richard Millett Q.C.
Essex Court Chambers

The issue

- A bank's standard form contractual documents often contain clauses that provide that:
  - The customer agrees that the bank has not made any representations to him.
  - The customer has not relied upon any representations made by the bank in entering into the contract.
  - The customer has exercised his independent judgment, or sought independent advice, in entering into the contract.
  - The customer agrees that the bank has not acted as his adviser.
- What is the effect of these clauses?

The English position I: evidential estoppel

- Lowe v Lombank [1960] 1 WLR 196: Diplock J held that non-reliance clauses could give rise to an evidential estoppel, but only if the bank could show that:
  - The non-reliance clause was clear and unambiguous;
  - The customer intended his representation to be acted upon by the bank, or at any rate conducted himself such that the reasonable person would think the representation was true; and
  - The bank in fact believed the customer's representation to be true, and was induced by such belief to act upon it.

The English position II: contractual estoppel

- Peekay Intermark Ltd v Australia & New Zealand Banking Group Ltd [2006] EWCA Civ 386:
  - Moore-Bick LJ stated that *"There is no reason in principle why parties to a contract should not agree that a certain state of affairs should form the basis for the transaction whether it be the case or not…Where parties express an agreement of that kind in a contractual document neither can subsequently deny the existence of the facts and matters upon which they have agreed…The contract itself gives rise to an estoppel"*
  - Unlike evidential estoppel, this new species of estoppel did not require the bank to prove intention and reliance. It was therefore much easier to establish.
- The English courts have followed Peekay in a number of cases. See, for example, the High Court and Court of Appeal decisions in JP Morgan Chase Bank v Springwell Navigation Corporation.

The Singaporean position

- Peekay was cited by the Court of Appeal in Orient Centre Investments Ltd v Société Générale [2007] SGCA 24.
- In Als Memasa v UBS [2012] SGCA 43: Chan Sek Keong CJ expressed concern that banks might be relying upon non-reliance clauses *"which unsophisticated customers might have been induced or persuaded to sign without truly understanding their potential legal effect"*.
- In Deutsche Bank AG v Chang Tse Wen [2012] SGHC 248, Philip Pillai J held, in light of Al Memasa, that he would be *"extremely hesitant to apply the doctrine of contractual estoppel"*.

Where do we go from here?

- The divergence in approach between the English and Singapore courts is perhaps not surprising, given the facts of the cases each have been asked to consider:
  - The English decisions, e.g. Peekay, Springwell, have involved financially sophisticated, experienced customers.
  - By contrast, Al Memasa and Deutsche Bank have both involved financially inexperienced, and relatively unsophisticated, individuals.
- Can the concept of contractual estoppel do justice to both situations?

Relevance of the Misrepresentation Acts

- Both the English and Singaporean Misrepresentation Acts state that term which *"would exclude or restrict…any liability to which a party to a contract may be subject by reason of any misrepresentation made by him"* must satisfy the requirement of reasonableness.
- Does this include non-reliance clauses?
- This issue has not yet been considered in Singapore.
- In England, Raiffeisen Zentralbank Osterrich AG v Royal Bank of Scotland [2010] EWHC 1392 (Comm) establishes that the distinction is between:
  - Clauses which go to whether the alleged representation was made at all (outside the statute); and
  - Clauses which exclude or restrict liability in respect of representations made (within the statute).

Post-2008 Claims against Banks for Negligent Investment Advice

Nicholas Lavender QC
Serle Court

Outline

1. Some customers can bring claims against their banks under the Act for damages caused by the bank's breach of the FCA's rules.
2. Banks cannot exclude or restrict their duties under the FCA's rules.
3. Even if not directly actionable, the FCA's rules remain relevant to actions against banks for negligent advice.
4. Central to the FCA's rules are the concepts of: (a) personal recommendations; and (b) suitability.
5. Breaches of procedural obligations in the FCA's rules will not give rise to a cause of action unless they cause loss.
6. It is relevant to any consideration of suitability to examine: (a) the claimant’s investment objectives; (b) his financial ability to bear risk; and (c) his understanding of risk.
7. These matters are also relevant to issues of reliance, causation and contributory negligence.

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1. Actions for breach of statutory duty

Financial Services and Markets Act 2000, s 138D

"A contravention by an authorised person of a rule made by the FCA is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty."

1. Actions for breach of statutory duty

- Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001/2256, regs. 3 & 6
- *Zaki v. Credit Suisse (UK) Ltd.* [2011] 2 C.L.C. 523; [2013] EWCA Civ 14
- *Titan Steel Wheels Ltd v Royal Bank of Scotland Plc* [2010] 2 Lloyd's Rep. 92
- *Camerata Property Inc. v. Credit Suisse Securities Europe Limited* [2012] EWHC 7 (Comm)
- *Grant Estates Ltd. v. The Royal Bank of Scotland* [2012] CSOH 133
- *Wilson v. MF Global UK Ltd* [2011] EWHC 138 (QB)

2. Banks cannot exclude or restrict their duties under the FCA's rules.

COBS 2.1.2R:

A firm must not, in any communication relating to designated investment business seek to:

(1) exclude or restrict; or

(2) rely on any exclusion or restriction of;

any duty or liability it may have to a client under the regulatory system.

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3. Relevance of the FCA's Rules to Negligence Actions

HH Judge Havelock-Allen in *Rubenstein v. HSBC Bank Plc* [2012] P.N.L.R. 7, at ¶ 87:

"In *Loosemoore v Financial Concepts* [2001] Lloyds PNLR 235 at 241, Judge Jack QC (as he then was) held in this court that failing to comply with the FIMBRA Rules was negligence because the skill and care to be expected of a financial adviser would ordinarily include compliance with the rules of the regulator. As a general proposition that must be right, and it was not suggested that Mr Marsden was not negligent if he breached the rules in COB. If, therefore, the right analysis is that the relationship between Mr Marsden and Mr Rubenstein was an advisory one, the scope of the duty which Mr Marsden owed to Mr Rubenstein in contract and in tort embraced the relevant requirements of COB, in particular as to the suitability of the product he was recommending him."

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4.Personal Recommendations and Suitability

COBS 9.2.1(1):

"A firm must take reasonable steps to ensure that a personal recommendation, ... , is suitable for its client."

"personal recommendation" means:

"a recommendation that is advice on investments, ... and is presented as suitable for the person to whom it is made, or is based on a consideration of the circumstances of that person."

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4. Personal Recommendations

- *Wilson v. MF Global UK Ltd* [2011] EWHC 138 (QB)
- *City Index Limited v. Balducci* [2012] 1 B.C.L.C. 317
- *Bank Leumi (UK) Plc v. Wachner* [2011] 1 C.L.C. 454

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4. Personal Recommendations

Eady J. in *Wilson*:

(at ¶94) Against this background, it is inappropriate to go through the hundreds of conversations that took place between Mr Wilson and Mr Gainsley, or even the relatively few that are available, with a view to classifying everything that fell from Mr Gainsley's lips according to a rigorous analysis into separate categories of "information", "opinion", "advice" and "recommendations". That is simply not the way the conversations were conducted. Obligations of that sort could not be imported without express written amendment to the terms of business governing relations between the parties.

(at ¶96) It is clear from the conversations that there was a good deal of banter and light-hearted badinage and, from having seen the transcripts and listened to a few samples from the audio tapes, it is clear to me that what was happening can best be characterised as exchanging information and "bouncing ideas" off each other or swapping hunches about the market. Much of it was spontaneous and off the cuff. It would be unfair and unrealistic to pick upon certain passages in Mr Gainsley's observations, with six or seven years of hindsight, and to conclude that he had suddenly changed into "advice mode" and was undertaking an obligation, on his own initiative, to give advice on behalf of his employers to an "intermediate customer". If such conversations were to be subjected regularly to analysis of that kind with a view to changing the express terms of the parties' relationship, brokers would not be able to operate and communications would soon be drastically curtailed.

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5. Procedural Obligations

Rix L.J. in Zaki *v. Credit Suisse (UK) Ltd.* [2013] EWCA Civ 14:

(at ¶38) *"Regulatory failures in obtaining information might support a case of unsuitability, but they were not sufficient proof of it."*

(at ¶79) *"If, however, the lending was in fact suitable, whatever a firm has done, properly or improperly under sub-rule (1)* [of COB 7.9.3], *then any failure under sub-rule (1) becomes mere water under the bridge, a matter of no importance."*

Nicholas Lavender QC, Serle Court

5. Procedural Obligations

Rix L.J. in *Rubenstein v. HSBC Bank Plc* [2012] P.N.L.R. 7(at ¶60):

> "The judge may be right in thinking that the procedural breaches only become important if they help to lead to an unsuitable recommendation: nevertheless the relevant rules are designed to assist the adviser not to fail substantively, and their breach makes such substantive failure the more likely. It may not be easy to give suitable advice: but it is harder to do so if one goes about it in the wrong way."

Rix L.J. in *Zaki v. Credit Suisse (UK) Ltd.* [2013] EWCA Civ 14 (at ¶79):

> "I accept, nevertheless, that a proven breach of the obligation of process will in the natural course of things lead a court to consider carefully, and if need be sceptically, a firm's case that it had taken reasonable steps or that the lending was suitable, despite any lack of care in the process leading to the lending arrangements: see, for instance, Rubenstein v. HSBC Bank plc [2012] EWCA 1184 at para [93]".

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6. Assessment of Suitability

COBS 9.2.2(1):

> A firm must obtain from the client such information as is necessary for the firm to understand the essential facts about him and have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, ...:

(a) meets his investment objectives;

(b) is such that he is able financially to bear any related investment risks consistent with his investment objectives; and

(c) is such that he has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

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7. Quantum Issues

- Causation:

Zaki v. Credit Suisse (UK) Ltd. [2011] 2 C.L.C. 523; [2013] EWCA Civ 14

- Remoteness:

Camerata Property Inc. v. Credit Suisse Securities Europe Limited [2012] EWHC 7 (Comm)
Rubenstein v. HSBC Bank Plc [2012] P.N.L.R. 7; [2013] P.N.L.R. 9

- Contributory Negligence:

Bank Leumi (UK) Plc v. Wachner [2011] 1 C.L.C. 454

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Post-2008 Claims against Banks for Negligent Investment

Nicholas Lavender QC
Serle Court

Finance, Property and Business Litigation in a Changing World

Concurrent Session 3C: Joint Ventures and Constructive Trusts

Speakers

Ms Amanda Tipples QC, *Maitland Chambers*

Associate Professor Pearlie Koh, *School of Law, Singapore Management University*

Joint Ventures and Constructive Trusts

Amanda Tipples QC

Friday, 26 April 2013

Finance, Property and
Business Litigation in a Changing World

A Joint Conference of
The Singapore Academy of Law and the
Chancery Bar of England and Wales

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(A) INTRODUCTION

1. The title of this Conference is "Finance, Property and Business Litigation in a Changing World". That is, of course, in a changing commercial world[1].

2. In the context of commercial joint ventures constructive trusts are often considered[2] when the joint venturers have fallen out in relation to the acquisition of property, typically land[3]. It is in these circumstances that the disappointed party may well seek to rely on the principle known as the "*Pallant v Morgan* equity" in order to try and remedy the situation and acquire an interest in the property which should have been the subject of the joint venture.

3. This *Pallant v Morgan* equity was identified by the Court of Appeal in *Banner Homes Group Plc v Luff Developments Ltd* [2000] Ch 372 ("***Banner Homes v Luff***"), supposedly based on the earlier decision of Harman J in *Pallant v Morgan* [1953] Ch 53.

4. The basis of the *Pallant v Morgan* equity is a common intention constructive trust: *Crossco No. 4 Unlimited v Jolan Ltd* [2012] 2 All ER 754, CA ("***Crossco***").

5. The fundamental ingredients of a common intention constructive trust in a commercial context are certainty as to the terms of the bargain between the parties and detrimental reliance.

6. The recent decision of *Crossco* has highlighted the limited room for the common intention constructive trust in the context of commercial joint ventures. I want to look at the reasons for this. In order to do so, I am going to focus on whether, when the joint venturers fall out with each other:

   (1) The common intention constructive trust is still relevant.

   (2) There needs to be a fiduciary relationship between the parties in order for a constructive trust to arise.

(B) USUAL FEATURES OF A COMMERCIAL CONTEXT

7. The legal form of the joint venture will commonly be one of the following:

   (1) a contractual alliance;

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[1] For that reason, I do not propose to consider joint ventures in a domestic context.

[2] Issues relating to "constructive trusts" will also arise when a third party has, for example, knowingly received the benefit of property or an opportunity, transferred to it by a joint venturer in breach of fiduciary duty (ie the second class of case identified in *Paragon Finance v D B Thakerar & Co* [1999] 1 All ER, 400 at 409e-g, per Millett LJ). This topic is outside the scope of this talk.

[3] Other property might include the acquisition of a business: see *Time Products Ltd v Combined English Stores Group Ltd*, 2 December 1974 (cited in Banner Homes v Luff at 393G-395H).

(2) a corporate joint venture;

(3) a limited liability partnership; or

(4) a partnership.

8. Whatever the form of the joint venture, the commercial parties contemplating it will:

   (1) be dealing at arm's length;

   (2) have access to, and usually take, legal advice about their respective rights and interests; and

   (3) usually reduce their agreements to writing and will not expect to be bound until a contract has been made. Indeed, the parties usually expect that it is the signing and exchanging of contracts that will trigger the rights and obligations contained within the contracts[4].

(C) PURCHASE OF PROPERTY: ONE PARTY "KEPT OUT OF THE RING" BY PRIOR AGREEMENT

The principle

9. In *Cobbe v Yeoman's Row Management Ltd* [2008] 1 WLR 1782, HL ("***Cobbe***") the principle was explained by Lord Scott in the following terms:

   "*If two or more persons agree to embark on a joint venture which involves the acquisition of an identified piece of land and a subsequent exploitation of, or dealing with, the land for the purposes of the joint venture, and one of the joint venturers, with the agreement of the others who believe him to be acting for the joint purposes, makes the acquisition in his own name but subsequently seeks to retain the land for his own benefit, the court will regard him as holding the land on trust for the joint venturers.*

   This would be either an implied trust or a constructive trust arising from the circumstances and if, as would be likely from the facts as described, the joint venturers have not agreed and cannot agree about what is to be done with the land, the land would have to be resold and, after discharging the expenses of its purchase and any other necessary expenses of the abortive joint venture, the net proceeds of sale divided equally between the joint venturers. A number of cases exemplify the operation of a constructive trust in such a situation. Pallant v Morgan [1953] Ch 43 was one such case."[5]

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[4] See *Cobbe* 1782F-G (para 68), per Lord Walker.

[5] At 1769E-H (para 30).

10. In relation to this statement of the principle, Lord Scott then went on to approve[6] what was said by Chadwick LJ in *Banner Homes v Luff* at 397 in relation to the reasons why a constructive trust could arise in this context.

11. In *Banner Homes v Luff* Chadwick LJ explained that:

"*It is the pre-acquisition arrangement which colours the subsequent acquisition [of the land] by the defendant and leads to his being treated as a trustee if he seeks to act inconsistently with it*".

Application of the principle

12. There are three points which are uncontroversial in relation to the application of the principle.

13. First, the claim to a constructive trust will fail unless there is a pre-acquisition agreement or understanding (see, for example, *Alan Hoo v Benjamin Lung* [2007] 3 HKLRD 169, CA; *Crossco*).

14. Second, there is no room for a constructive trust if the parties have expressly agreed that they are not to be bound unless and until formal contracts are exchanged. This is because in these circumstances they have expressly negatived an intention to create legal relations; and, in this respect, equity will follow the law: see *London & Regional Investments Ltd v TBI Plc* [2002] EWCA Civ 355 ("***LRI Ltd***") at para 47, per Mummery LJ; *Kilcarne Holdings Ltd v Targetfollow (Birmingham) Ltd* [2005] 2 P & CR 8, 105 ("***Kilcarne***") at 162 (para 229), per Lewison J; and *Attorney General of Hong Kong v Humphreys Estate (Queen's Gardens) Ltd* [1987] AC 114).

15. Third, if one party already owns, or is entitled to, the property in question, then the principle will not apply. This is because there will be no "pre-acquisition arrangement", in the sense that both parties are equally free to bid for the property (see *LRI Ltd* at para 47, per Mummery LJ; *Kilcarne* at 165 (para 242)). Rather, in these circumstances, any arrangement will be one of "post-acquisition" and the property cannot be described as "joint venture property" (see, for example, *Cobbe* at 1171H-1772B (para 36), per Lord Scott).

What is the legal basis of the principle?

16. What is it about the actual arrangement made between the parties before the acquisition of the property that gives rise to the constructive trust?

17. For example, does the constructive trust arise out of:

(1) the terms of arrangement, however vague or uncertain those terms are?; or

[6] At 1770D-E (para 32).

(2) the fiduciary nature of the relationship between the parties resulting from the arrangement?

18. To answer this question one has to look at *Pallant v Morgan* itself and then the decision in *Banner Homes v Luff*.

(D) PALLANT v MORGAN

The facts

19. The plaintiff, Bertie Pallant, and the defendant, Mr Morgan, were neighbouring landowners. Some woodland on a nearby estate came up for sale at auction. They both wished to purchase this woodland. However, they knew that, if they bid against each other, the only person who would profit would be the vendor of the woodland. It was therefore in their respective interests to agree before the sale not to compete with each other.

20. Proposals were then made as to how the land should be divided, and negotiations took place between the parties' respective surveyors. One particular parcel of land, lot 16, was of interest to both parties and had valuable timber on it.

21. As a result of these negotiations, by the day of the auction the extent of the parties' differences had crystallised, the surveyors had reached certain tentative conclusions but the parties had not reached a concluded agreement.

22. Importantly, they had not agreed a number of crucial terms, namely:

(1) the basic price of the land per acre (although they had agreed the basic price for the land should be *between* £3 and £5 an acre);

(2) how lot 16 would be divided between them (although the parties were near agreement, an area marked "B" on the plan was "left in doubt" (page 46)); and

(3) how the price of the valuable timber on lot 16 should be determined, in the event of disagreement.

23. The auction was attended by the surveyors. The principals did not attend. Each agent had instructions to bid for lot 16. The plaintiff's agent, a Mr Mason, had instructions to bid for up to £2,000. The defendant's agent, a Mr James, had instructions to bid for up to £3,000. The Defendant's agent could therefore outbid the plaintiff's agent, Mr Mason.

24. Mr James acquired lot 16 for his client for £1,000 and the plaintiff's agent, Mr Mason, refrained from bidding in respect of lot 16.

25. Mr Mason did not do so because he had agreed not to bid on the faith of an assurance from the defendant's agent that, if he refrained from bidding, the defendant would, if he acquired lot 16, convey identified portions of the land to the plaintiff at a price to be settled between them.

Decision of Harman J

26. Mr Justice Harman held that the plaintiff was not entitled to specific performance of the agreement as there was "*too much left undecided*" (page 48).

27. However, that did not mean that the plaintiff's claim had to fail as "*to allow the defendant to retain lot 16 under these circumstances would be tantamount to sanctioning a fraud on his part …*" (page 48).

28. He referred to the decision of Malins V-C in *Chattock v Muller*[7] 8 ChD 177 and held that:

    "*In my judgment, the proper inference from the facts is that the defendant's agent, when he bid for lot 16, was bidding for both parties on an agreement that there should be an arrangement between the parties on the division of the lot if he were successful. The plaintiff and the defendant have failed to agree on a division, and the court cannot compel them to agree. The best it can do is to decree that the property is held by the defendant for himself and the plaintiff jointly, and if they still fail to agree on a division the property must be resold, either party being at liberty to bid, and the proceeds of sale divided equally repaying the defendant the £1,000 which he paid with interest at 4 per cent.*" (emphasis added)

29. In the final sentence of his judgment, Harman J summarised the position by stating that the plaintiff's case rested on:

    "*the fact that his agent was kept out of the ring at the action by a promise that, if he did not bid, an agreement would be reached*".

30. The defendant's agent therefore held the land on trust (whether a constructive or implied trust[8]) for the plaintiff and the defendant in equal shares.

Pallant v Morgan: 1953 to January 2000

31. Until the Court of Appeal's decision in *Banner Homes v Luff*, *Pallant v Morgan* (and also the earlier case of *Chattock v Muller*) was, at least in

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[7] In this case the purchaser was considered to have acted both for himself and as agent for the plaintiff as joint purchasers, following a pre-acquisition agreement for the division of land. On the facts, the parties' agreement was considered sufficiently certain to constitute a contact. However, Malins V-C commented further that: "*In a case like this, where the Defendant has acquired the estate or part of it by a fraud on the plaintiff, I think the Court would be bound, if possible, to overcome all technical difficulties in order to defeat the unfair course of dealing of the Defendant.*"

[8] *Cobbe* at 1769G, per Lord Scott.

some quarters, regarded as an example of the application of the doctrine of *Rochefoucauld v Boustead*[9]. This doctrine permits equity to intervene in order to prevent equitable fraud where it is unconscionable for the legal owner to rely on the lack of statutory formalities.

32. So *Pallant v Morgan* established a ground on which the court could intervene, in the absence of specific performance, to prevent fraud where A purchased property from a third party pursuant to some agreement or arrangement (which was not valid at law) between A and B that:

    (1) A would hold the property for B (or jointly with B); or

    (2) A would dispose of all or part of the property to B.

33. To be valid at law:

    (1) where the arrangement contemplates the creation of a trust of the land, the declaration of trust must satisfy the requirement for writing as set out in section 53(1)(b) of the Law of Property Act 1925; or

    (2) where the arrangement contemplates an onward sale, to be valid at law the agreement needs to be (i) contractually certain, and (ii) comply with all the formalities required by section 2(1) of the Law of Property (Miscellaneous Provisions) Act 1989[10] (in Singapore see, for example, section 6(d) of the Land Titles Act and section 53 of the Conveyancing and Law of Property Act (Cap 61)).

34. The crucial issue was understood to be whether the acquiring party had accepted the property *ab initio* in the role of agent, and therefore as a fiduciary, which it could not then deny. This meant that the equity only operated in the fairly narrow field of the joint acquisition of property[11].

35. Pausing there, it is important to keep in mind that there are <u>two</u> distinct aspects to the agreement or arrangement made between the parties in these circumstances.

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[9] [1897] 1 Ch 196 (CA), per Lindley LJ at 206: "*... the Statute of Frauds does not prevent the proof of a fraud; and ... it is a fraud on the part of a person to whom land is conveyed as a trustee, and who knows it was so conveyed, to deny the trust and claim the land for himself. Consequently, notwithstanding the statute [section 7 of the Statute of Frauds], it is competent for a person claiming land conveyed to another to prove by parol evidence that it was so conveyed upon trust for the claimant, and that the grantee, knowing the facts, is denying the trust and relying upon the form of conveyance and the statute, in order to keep the land for himself.*" See "*Formalities for Trusts of Land and the Doctrine in* Rochefoucauld v Boustead" (1984) 43 CLJ 306 *T G Youdan* at page 329, footnote 14.

[10] This is the relevant legislation after 27 September 1989. Section 2(1) of the 1989 act superseded section 40 of the Law of Property Act 1925, which then ceased to have effect.

[11] See "*Constructive Trusts and Estoppel*" (2003) 23 LS 311 *Nield* at 315. There is an example of this in *Du Boulay v Raggett* (1988) 58 P & CR 138 at 150-151, Mr Robert Wright QC (sitting as a Deputy Judge of the High Court). This case, although decided in November 1988 and involving some of the same Counsel (C Purle), was not cited in *Banner Homes v Luff*.

36. First, there is the capacity in which the bidder or acquiring party was acting. Certainty is required here. If it was not certain that the bidder or acquiring party was purchasing the property in a fiduciary capacity, eg as an agent for the disappointed party, then that was fatal to the disappointed party's claim to a constructive trust. This is the crucial point referred to at paragraph 34 above.

37. Second, there are the terms on which the land was to be purchased, or resold, by the acquiring party. Although an agreement in relation to the land was required between the parties, no certainty was required as to the terms of that agreement or understanding (ie in relation to the part of the property to be held or sold to the non-acquiring party or the consideration to be paid).

38. Paragraphs 31 to 37 above therefore summarise the understanding of *Pallant v Morgan* prior to the decision of the Court of Appeal in *Banner Homes v Luff*.

(E) THE "*BANNER HOMES* CONSTRUCTIVE TRUST" OR THE "*PALLANT v MORGAN EQUITY*"

Facts

39. In *Banner Homes v Luff*, Luff was interested in purchasing a development site but wanted a joint venture partner. Luff was introduced to Banner Homes and a joint venture agreement was reached in principle. Solicitors were instructed to finalise its detailed terms. Luff then agreed to purchase the site, but had second thoughts about working with Banner Homes. Luff did not inform Banner Homes of its change of mind until just prior to its completion of the purchase of the site through its wholly owned subsidiary. It seemed that Luff hoped that a better joint venture partner would turn up, but it wanted to keep Banner on hold and exclude it from making a rival bid for the development site.

40. When Luff denied Banner Homes an interest in the land acquired by its wholly owned subsidiary, Banner Homes issued proceedings claiming, amongst other things, a declaration that one-half of the shares in the company were held by Luff on trust for it.

41. The trial judge:

    (1) Rejected Banner Homes' claim that there was a concluded agreement for a joint venture.

    (2) Found as a fact that Luff had led Banner Homes to understand that it intended to enter into a joint venture, but Luff then had second thoughts which it did not share with Banner Homes for fear that, if the plaintiff knew, the plaintiff would make a rival bid for the site.

(3) Rejected Banner Homes' claim to a constructive trust on the basis that equity could not be used to turn an understanding "*implicitly qualified by the right of either side to withdraw, into an unqualified arrangement or undertaking which is denied any such right*". This was because "*It is equity's function, where it can, to give effect to the parties' bargain, but not to make or alter it for them*" (382D; per Blackburne J).

42. Banner Homes appealed. The Court of Appeal overturned the trial judge's decision and decided that Luff held one half of the shares in the company (which owned the development site) on trust for Banner Homes.

43. The Court of Appeal reached this conclusion by establishing, and invoking, the *Pallant v Morgan* equity.

Ingredients of the Pallant v Morgan equity (or the Banner Homes constructive trust)

44. Chadwick LJ (with whom Evans LJ and Stuart-Smith LJ agreed) identified the following features as giving rise to the *Pallant v Morgan* equity:

(1) The arrangement or understanding on which it is based should precede the acquisition of the relevant property by one party to that arrangement (397F-398A).

(2) It is unnecessary that the arrangement or understanding should be contractually enforceable, or is too uncertain to be enforced as a contract (398B-C).

(3) It is necessary that the pre-acquisition arrangement or understanding should contemplate that one party ("the acquiring party") will take steps to acquire the relevant property; and that, if he does so, the other party ("the non-acquiring party") will obtain some interest in that property 398C-D). Further, it is necessary that the acquiring party has not told the non-acquiring party before the acquisition that he no longer intends to honour the arrangement or understanding (398D).

(4) It is necessary that, in reliance on the arrangement or understanding, the non-acquiring party should do (or omit to do) something which confers an advantage on the acquiring party in relation to the acquisition of the property; or is detrimental to the ability of the non-acquiring party to acquire the property on equal terms (398E). Lord Justice Chadwick explained this point further by saying:

"*It is the existence of the advantage to one, or detriment to the other, gained or suffered as a consequence of the arrangement or understanding, which leads to a conclusion that it would be inequitable or unconscionable to allow the acquiring party to retain the property for*

himself, in a manner inconsistent with the arrangement or understanding which enabled him to acquire it"[12].

He then continued by explaining that *Pallant v Morgan* itself provided an example of this principle as:

"*The plaintiff's agreement (through his agent) to keep out of the bidding gave an advantage to the defendant – in that he was able to obtain the property for a lower price than would otherwise have been possible; but the failure of the plaintiff's agent to bid did not, in fact cause detriment to the plaintiff – because, on the facts, the agent's instructions would not have permitted him to outbid the defendant. Nevertheless, the equity was invoked.*"[13]

(5) The existence of both advantage and detriment is not essential – either will do (399B). This is because Chadwick LJ explained:

"*what is essential is that the circumstances make it inequitable for the acquiring party to retain the property for himself in a manner inconsistent with the arrangement or understanding on which the non-acquiring party has acted.*"[14]

45. It is the second and fifth ingredients of the *Pallant v Morgan* equity which are now controversial. This is because, as is explained below, they do not square with the circumstances which can give rise to a common intention constructive trust in a commercial context.

Chadwick LJ's analysis of constructive trusts

46. Chadwick LJ's five propositions were derived from an analysis of the law of constructive trusts which began, significantly, by Chadwick LJ accepting as correct what Robert Walker LJ had held in *Yaxley v Gotts* [2000] Ch 162[15] at 176C-G and, in particular, that:

"*in the area of a joint enterprise for the acquisition of land the two concepts [a common intention constructive trust and proprietary estoppel] co-incide.*"[16]

47. Chadwick LJ then analysed a number of decisions at first instance where equity has imposed a constructive trust on property acquired by one person in furtherance of some arrangement or understanding with another that, by keeping out of the market, that other would, nevertheless, be able

[12] 398E-G.
[13] 398H-399I.
[14] 399B-C.
[15] *Pallant v Morgan* was not cited in *Yaxley v Gotts*.
[16] 384C; see *Yaxley v Gotts* at 176E. Robert Walker LJ then said that this point was brought out in the following well known cases: *Gissing v Gissing* [1971] AC 886 at 905, per Lord Diplock; *Lloyds Bank Plc v Rosset* [1991] 1 AC 107 at 132, per Lord Bridge of Harwich; *Grant v Edwards* [1986] Ch 638 at 656 per Sir Nicolas Browne-Wilkinson V-C (and these cases are all referred to by Chadwick LJ in *Banner Homes* (see 384E-385D)).

to acquire some interest in the property. The five cases he analysed were *Chattock v Miller*, *Pallant v Morgan*, *Holiday Inns Inc v Broadhead* (unreported) 19 December 1969 and, at trial, (1974) 232 EG 951, *Time Products Ltd v Combined English Stores Group Ltd* (unreported), 2 December 1974 and *Island Holdings Ltd v Birchington Engineering Ltd* (unreported), 7 July 1981.

48. It is clear from the Court of Appeal's decision in *Banner Homes v Luff* that the *Pallant v Morgan* equity arises from a common intention constructive trust: see *Crossco*.

(F) BANNER HOMES v LUFF: DEVELOPMENTS SINCE 2000

Binding in Court of Appeal and below

49. The decision in *Banner Homes v Luff*:

(1) has been referred to by the Court of Appeal on a number of occasions without disapproval: see *LRI Ltd*, *Kilcarne* [2005] EWCA Civ 1355 and *Clarke v Corless* [2010] EWCA Civ 388. However, these cases do not explore the rationale for the *Pallant v Morgan* equity;

(2) has been cited with approval by the House of Lords in *Cobbe*[17]; and

(3) cannot be doubted at the level of the Court of Appeal: *Crossco*.

50. However, disappointed parties in a failed joint venture have had very little success trying to rely on the *Pallant v Morgan* equity established by *Banner Homes v Luff*. Examples, include the following cases:

(1) *LRI Ltd* supra;

(2) *Ong Heng Chuan v Ong Boon Chuan* [2003] 2 SLR 469;

(3) *Kilcarne* supra;

(4) *Button v Phelps* [2006] EWHC 53 (Ch), Robert Englehart QC (sitting as a Deputy Judge of the Chancery Division);

(5) *Cayzer v Beddow* [2007] EWCA Civ 644; and

(6) *Crossco*. In this recent case the claimant sought to rely on the *Pallant v Morgan* equity in the context of a demerger of a group of companies, the shares in which were held by members of the same family.

51. Nevertheless, a recent example of a case where the *Pallant v Morgan* equity was held to apply was *Kearns Brothers Ltd v Hova Developments*

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[17] At 1770D-E (para 32), per Lord Scott.

Ltd [2012] EWHC 2968 (Ch), Edward Bartley Jones QC (sitting as a Deputy High Court Judge).

Academic criticism of the decision

52. One academic said this of *Banner Homes v Luff*:

    "*Reading the decision is akin to attempting to put together pieces from different jigsaw puzzles. Not all the pieces from any one puzzle are present, but they have been forced into place, resulting in a distorted image. The pieces have been taken from the laws of constructive trusts, estoppel and restitution, and the resulting distorted image is named "the* Pallant v Morgan *equity*""[18].

53. The decision has received a "*very mixed reception*"[19] from academic commentators: see "*Constructive Trusts and non-binding agreements*" [2001] 65 Conv 265, Michael Thompson; "*Constructive trusts and estoppel*" (2003) 23 LS 311, Sarah Nield; "*Constructive trusts on a receipt of property sub condition*" (2004) LQR 667, Ben McFarlane; "*Constructive trusts and proprietary estoppel: the search for clarity and principle*" [2009] 74 Conv 104, Sir Terence Etherton.

54. There are a number of reasons why academics are less than enthusiastic about *Banner Homes v Luff*.

55. First, it is said that the Court of Appeal extended the categories of constructive trust, and recognised a new situation when a constructive trust will be imposed in a commercial context.

56. The Court of Appeal should not have done this because, although the categories of constructive trust are not closed, the categories should only be extended where the courts "*are prepared to lay down some new principle which will apply generally*" and "*no such principle should be established without the fullest consideration of its probable effects on the interests of third parties …*" (Constructive Trusts (3rd ed, 1997) *Oakley* at page 28). The Court of Appeal did not give any detailed consideration to the consequences of this new constructive trust in a commercial context or to the implications resulting from the features of the *Pallant v Morgan* identified by Chadwick LJ.

57. Second, the Court of Appeal misunderstood the decision in *Pallant v Morgan*.

58. In *Pallant v Morgan* the intervention by Harman J to prevent fraud was based on agency. The Defendant's agent acted as agent for both parties in bidding for the land, and he did so pursuant to an agreement that the parties would decide on the division of the land if his bid were successful.

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[18] [2002] 67 Conv 35 at 36, per Nicholas Hopkins.

[19] *Crossco* at para 80, per Etherton LJ.

The decision of Harman J was <u>not</u> based on any of the factors identified by Chadwick LJ in *Banner Homes v Luff* (see [2002] 67 Conv 35 at 39, 40).

59. Third, the Court of Appeal was wrong to hold that, provided an advantage is conferred on the defendant, there is no need for the claimant to establish that it has suffered any corresponding detriment.

60. The *Pallant v Morgan* equity therefore provides for a "gain based constructive trust", without any indication of a breach of duty. This means that, in a commercial context, the Court can confer proprietary rights solely in response to an unconscionable gain in favour of a party (a) who has not suffered any loss, and (b) to whom no equitable duty is owed (see *Hopkins* [2002] 67 Conv 35 at 49; and *Nield* (2003) 23 LS 311 at 329).

61. Fourth, it is said that remarkably high standards of conduct are now demanded in commercial transactions, and it does not take much for what might be regarded as acceptable commercial tactics to be seen as a breach of duty giving rise to the imposition of a constructive trust (see *Nield* (2003) 23 LS 311 at 316, 325).

<u>(G) CORRECT LEGAL BASIS OF THE PALLANT v MORGAN EQUITY</u>

62. Is the identification of the *Pallant v Morgan* equity as arising from a common intention constructive trust correct as a matter of legal principle?

63. For example:

    (1) Is it consistent with the decision of the House of Lords in *Stack v Dowden* [2007] 2 AC 432 ("***Stack***") and the recent decision of the Supreme Court in *Jones v Kernott* [2012] 1 AC 776 ("***Jones***")?

    (2) Is it based on the correct analysis of *Pallant v Morgan* itself?

Views of Sir Terence Etherton C

64. Sir Terence Etherton, the Chancellor of the Chancery Division of the High Court of England & Wales, considers that the analysis of the *Pallant v Morgan* equity as a common intention constructive trust is simply wrong. He has explained his reasons in his judgment in *Crossco*[20].

65. Indeed, in *Crossco*[21] he says:

    "*the passage of time and developments in the law have, in my judgment, shown the connection between the common intention constructive trust and the* Pallant v Morgan *equity as explained and applied in* Banner Homes *to be untenable.*"

[20] See also "*Constructive Trusts and Proprietary Estoppel: the search for clarity and principle*" [2009] 73 Conv 104, Sir Terence Etherton.
[21] Para 87.

66. Rather, Etherton LJ considers that the cases in which the *Pallant v Morgan* equity has been applied can be explained in a wholly conventional way as examples of a breach of an existing fiduciary duty[22].

The Pallant v Morgan equity does <u>not</u> have the ingredients of a common intention constructive trust

67. The common intention constructive trust and proprietary estoppel are based on an agreement to share beneficial ownership (trust) or an assurance of rights (estoppel) upon which the claimant has relied to his detriment. They operate in a common landscape, namely unconscionable dealings with land where there has been a failure to comply with the statutory formalities necessary to create or transfer an interest in land.

68. The position today is that Courts are less enthusiastic about the notion that proprietary estoppel and a common intention constructive trust can be completely assimilated: see *Stack* at 448G-449A (para 37), per Lord Walker[23]. In *Stack* Lord Walker explained:

    "*Proprietary estoppel typically consists of asserting an equitable claim against the conscience of the 'true' owner. The claim is a 'mere equity'. It is to be satisfied by the minimum equity necessary to do justice (Crabb v Arun District Council [1976] Ch 179, 198), which may sometimes lead to no more than a monetary award. A 'common intention' constructive trust, by contrast is identifying the true beneficial owners or owners, and the size of their beneficial interests*".

69. Nevertheless, in *Herbert v Doyle* [2011] 1 EGLR 119, the Court of Appeal, whilst appreciating that the distinction between proprietary estoppel and constructive trust must be kept in mind, held that, in some situations including a commercial context, the effect of *Cobbe* is that:

    "*both doctrines have a requirement for completeness of agreement with respect to an interest in property. Certainty as to that interest in those situations is a common component.*"[24]

70. Arden LJ explained that there was a "common thread" running through the speeches of Lord Scott and Lord Walker in *Cobbe*. She then said this:

    "*Applying what Lord Walker said in relation to proprietary estoppel also to constructive trust, that common thread is that, if the parties intend to make a formal agreement setting out the terms on which one or more of the parties is to acquire an interest in property, <u>or, if further terms for that acquisition remain to be agreed between them so that the interest in property is not clearly identified,</u> or if the parties did not expect their agreement to be immediately binding, <u>neither party can rely on</u>*

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[22] This corresponds with the view before 2000, when *Banner Homes v Luff* was decided by the Court of Appeal (see paragraph 34 above).
[23] Thereby moving away from his own analysis in *Yaxley v Gotts* [2000] Ch 162 at 176.
[24] Para 56, per Arden LJ.

constructive trust as a means of enforcing their original agreement. In other words if their agreement (which does not comply with section 2(1)) is incomplete, they cannot utilise the doctrine of proprietary estoppel or the doctrine of constructive trust to make their agreement binding on the other party by virtue of section 2(5) of the [Law of Property (Miscellaneous Provisions) Act] 1989 …[25]" (underlining added).

71. Therefore, in a commercial context, the two key ingredients of a common intention constructive trust are:

    (1) a bargain between the parties which is certain in its terms; and

    (2) detrimental reliance.

72. In *Banner Homes v Luff* the common intention constructive trust identified by Chadwick LJ as giving rise to the *Pallant v Morgan* equity had neither of these ingredients (see 398B-C and 399B).

73. Indeed, in *Crossco* Etherton LJ said that, "*properly analysed*", the *Banner Homes* constructive trust is not an example of a common intention constructive trust. This is because he said that the label common intention constructive trust can be traced to the line of well-known decisions of the House of Lords[26] that concern "joint ventures" in a domestic context. He said that these decisions were:

    "*clearly, in retrospect, … a specific jurisprudential response to the problem of a presumption of resulting trust and the absence of legislation for resolving disputes over property ownership where a married or unmarried couple have purchased property for their joint occupation as a family home.*"

74. Etherton LJ explained that the jurisprudence in this distinctive "domestic" area has been driven by policy considerations and the special facts that normally apply in the dealings between those living in an intimate relationship. This includes the fact that such parties do not normally take legal advice about, or expect to reduce to a formal or indeed any written agreement, their mutual property rights and interests in the family home (*Crossco* at para 85).

75. This he said is to be contrasted with the commercial context[27], when parties do take advice and do not expect to be bound until a contract has been signed (*Crossco* at para 87). Indeed the special facts which normally arise in a domestic context did not apply in *Banner Homes v Luff*, nor in

[25] See paragraph 33(2) above.
[26] *Gissing v Gissing* [1971] AC 886, *Pettit v Pettit* [1970] AC 777, *Lloyd's Bank v Rosset* [1991] 1 AC 107, *Stack* and *Jones* (although this is a decision of the Supreme Court).
[27] Although whether it is appropriate to draw such a clear distinction between a domestic and a commercial context is a matter of academic debate: "*The relevance of context in property law: a case for judicial restraint?*" Hopkins (2011) 31 LS 175.

any of the cases referred to in that case as examples of the *Pallant v Morgan* equity (see paragraph 40 above; *Crossco* at para 86).

Breach of fiduciary duty

76. In *Crossco* Etherton LJ said that it was unnecessary to resort to the common intention constructive trust to explain the cases in which the *Pallant v Morgan* equity was, or is said to, have been applied. Rather, he said these cases can all be explained by the existence and breach of a fiduciary duty.

77. They are examples of a fiduciary relationship of trust and confidence, which arises where one party undertakes to act in the interests of another, or where he places himself in a position where he is obliged to act in the interests of another[28].

78. The core obligation of a fiduciary in these circumstances is the obligation of loyalty[29].

79. Further, Etherton LJ said that it was sound policy that the *Pallant v Morgan* equity should be explained on the basis of breach of fiduciary duty because:

   "*this policy recognises the need for certainty in commercial transactions, and it reflects the usual practice and desirability for business transactions to be effected by binding written contracts, often after the receipt of legal advice*"[30].

80. This explanation of the *Pallant v Morgan* equity also means that:

   (1) The reason why there is no need for there to be a complete agreement or understanding between the parties as to how the land is to be owned or sold on can easily be explained (*Crossco* at para 95). This point is irrelevant, provided that it is clearly established that the acquiring party is acting in a fiduciary capacity.

   (2) The cases in which the equity has been applied can be seen as examples of cases in which the Court has, pursuant to a constructive trust, deprived the defendant of the advantage obtained in breach of the fiduciary relationship between the parties (*Crossco* at para 95).

81. Arden LJ agreed that the decision of *Pallant v Morgan* could be interpreted on the basis of breach of fiduciary duty[31]. McFarlane LJ was attracted to Etherton LJ's analysis of the cases and thought Etherton LJ might be

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[28] This is the first class of case described in *Paragon Finance Plc v D B Thakerer & Co* [1999] 1 All ER 400, CA at 408-409 per Millett LJ.

[29] See, for example, *Bristol and West Building Society v Mothew* [1998] Ch 1; and "*Equity's place in the law of commerce*" (1998) 114 LQR 214 at 219, P J Millett.

[30] Para 94; See also para 133 (per Arden LJ).

[31] Para 128.

correct[32]. Nevertheless, they both considered that they were bound by *Banner Homes v Luff* to take the view that the *Pallant v Morgan* equity arises from a common intention constructive trust.

82. The decision in *Crossco* has not been appealed to the Supreme Court.

Fiduciary obligations in a commercial context

83. This means that in a commercial context, in the absence of an accepted basis of a fiduciary relationship such as agency or partnership, particular and special features are required for such fiduciary duties to arise between the co-venturers. This is possible, although the circumstances are limited: see *Crossco* at para 88; Snell's Equity (32nd Ed; 2010) ("**Snell**") at page 178; Constructive Trusts (3rd Ed; 1997) *Oakley* at page 99 et seq.

84. The editors of Snell explain at pages 176-178 (based on a number of well known authorities cited in the footnotes) that:

(1) It is possible for fiduciary obligations to arise in a commercial relationship. An obvious example is commercial agency.

(2) However, fiduciary relationships do not commonly arise in a commercial setting outside the settled categories of fiduciary relationship, ie trustee and beneficiary, agent and principal, promoter and company, partners, director and company.

(3) This is because it is normally inappropriate to expect a commercial party to subordinate its own interests to those of another commercial party. However, if that expectation is not inappropriate in the circumstances of the relationship, fiduciary duties will arise.

(4) Joint venturers have been held to owe fiduciary duties to one another, but not all joint venturers necessarily involve such duties.

(5) While it has been suggested that joint ventures are inherently fiduciary because of their similarity to partnership, the term "joint venture" is a business term which does not have a precise legal meaning. Indeed, there are a number of different legal forms of joint venture: see paragraph 7 above.

(6) It is unwise for such an ill-defined term as "joint venture" to be the trigger for a category of fiduciary relationship. It is preferable for joint ventures not to be treated as a settled category of fiduciary relationship but an individual joint venture may be treated as a fiduciary relationship if, after a meticulous examination of its own facts, a fiduciary expectation is found to be appropriate between commercial parties bearing in mind the points made at (1) to (3) above.

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[32] Paras 121-122.

85. Therefore, in order to identify a fiduciary relationship outside agency or partnership, there needs to be cogent evidence to show that the non-acquiring party placed himself in a position of trust and confidence, or vulnerability and dependence, vis-à-vis the acquiring party. If a claimant has, for example, entrusted to the defendant the performance of a job, such as the negotiation of a contract on his behalf or for his benefit, and the claimant then relies on the defendant to do that job for him, those features are, depending on the particular circumstances, very likely to give rise to a fiduciary relationship.

86. It is beyond the scope of this talk to say any more about fiduciary relationships. However, there is a very helpful analysis of the recent law and articles about fiduciary obligations in *Ross River Ltd v Waveley Commercial Ltd* [2012] EWHC 81 (Ch), per Morgan J at paragaphs 235 to 255.

(H) CONCLUSION

87. A disappointed party's ability to claim an interest in property is therefore extremely limited if the joint venture has failed and there is no legally enforceable contract.

88. Reverting to the questions I posed at the outset:

    (1) Is the common intention constructive trust still relevant in this context?

    It is only relevant as long as *Banner Homes v Luff* remains good law. However, I do not consider that it has a future as *Banner Homes v Luff* is unlikely to survive scrutiny in the Supreme Court. I therefore very much doubt that this type of constructive trust will be of continued relevance in the context of failed joint ventures.

    (2) Does there need to be a fiduciary relationship between the parties in order for a constructive trust to arise?

    In order to successfully claim that a constructive trust has arisen in the context of a failed joint venture, the "safe" answer to this question must be "Yes". This is because the decision in *Banner Homes v Luff* is vulnerable beyond the Court of Appeal. However, as long as *Banner Homes v Luff* remains good law, the existence of such a relationship is not strictly speaking necessary.

PROFILE OF THE SPEAKER

Amanda Tipples QC is experienced in general chancery and commercial litigation, in particular real property and landlord and tenant, traditional chancery, partnership, insolvency, charities, VAT and Duties and confiscation proceedings. She has extensive court and specialist tribunal advocacy experience.

Before taking silk, Amanda was one of the Junior Counsel to the Crown (appointed to undertake civil advocacy and advisory work for government departments) for over eight years and, from January 2006, was on the A Panel, the most senior of the three panels of Junior Counsel to the Crown.

Amanda is a Recorder (Crown Court) and also acts as an arbitrator and mediator.

She is a member of Maitland Chambers and more information about her profile is available at www.maitlandchambers.com.

Verbatim Transcript of Concurrent Session 3C: Joint Ventures

Amanda: We've already heard various talks on constructive trusts so far. Some of the speakers spoke on fiduciary duties and when they arise. This morning we've heard about joint ventures. I'm going to speak about a topic that touches on these areas but forms a niches between them – and that is the Pallant v Morgan equity.

Now, the focus of this conference is litigation in a changing commercial world. In many disappointed expectations situations, parties may seek to rely on Pallant v Morgan equity. In Banner Homes v Luff [2000], the term "Pallant v Morgan equity" was coined. In Crossco v Jolan, the court held that this kind of equity is on the basis of a common intention constructive trust.

What I want to look at are 2 points: first, whether the CICT in this kind of situation is still relevant, second, whether a fiduciary relationship is required.

The principle behind a P v M equity is recently summarised by Lord Scott in cobbe v Yeomans Row: where 2 or more persons agreed to proceed with a joint venture that involves acquisition of land by one party, and where subsequently, that party denies the agreement, a constructive trust can arise.

It is not debated that a pre-acquisition arrangement is required. Also, there is no room for a CT to arise if the negotiations between the parties are subject to contract. Third, if the property is already owned by one party before the JV proceeded, there is no CT.

Does the CT arise from the nature of the r/s between the parties, or from the understanding they have reached over the property?

[Next: brief facts of Pallant v Morgan and Harman J's decision]

[Then: brief facts of Banner Homes v Luff and Chadwick LJ's analysis]

According to Chadwick LJ, the Pallant v Morgan equity has the following features:

1. There is a pre-acquisition arrangement
2. It does not matter if it is uncertain
3. The acquiring party will buy the property
4. The non-acquiring party must rely on arrangement to confer advantage on the acquiring party
5. The acquiring party must gain an advantage or the non-acquiring to his/her detriment

However, since 2000, academics have criticised the decision in Banner Homes. Among others, the criticisms were that:

- the CT explained is a new category
- The court in Banner Homes had misunderstood Pallant v Morgan
- Detriment must be required
- The standards set were too high for commercial deals

In Crossco [2012], Arden and McFarlane LJJ considered the Court of Appeal bound by the precedent of Banner Homes to treat the trust as a common intention trust. Etherton LJ opposed the majority's view about Pallant v Morgan equity. He said that it is "untenable" to say that the P v M equity is on the basis of a CICT. Instead, the judge explained that it is an example of the breach of an existing fiduciary duty.

What exactly are the ingredients for a CICT? From cases such as Stack v Dowden, Cobbe v Yeomans Row and Herbert v Doyle, we know that in commercial contexts there must be a bargain with certain terms as well as detrimental reliance. What is crucial is that in Banner Home, these 2 aspects were not present. According to Etherton LJ, the CICT is only limited to domestic contexts. P v M equity really arises when a fiduciary duty exists and that duty is breached. This rationale, he stated, is a sound policy and results in certainty in the commercial context. It explains why there is no need for a complete bargain and explains how the defendant is deprived of any advantage.

If one takes Etherton LJ's view, one has to consider next when fiduciary obligations will arise in such commercial contexts where parties negotiate at arm's length, e.g. parties have trust and confidence in each other.

To conclude, there is uncertain future for the CICT in the context of failed JVs. Also, the existence of a fiduciary relationship is now very relevant should a matter reach the Supreme Court.

Pearlie: I want to talk about 3 issues when JVs fail.

It is quite normal for directors to be nominated to the board of JV corporations. It is trite that directors owe an overriding duty of loyalty to the company. There is usually alignment between the interests of the JV partners and the JV itself, so usually nominee directors can carry out their duties properly. However, where conflicts arise between the parties, the interests may change and the directors' conflict of interests arises.

[Facts of Golden Village v Phoon (2006) and decision. High Court; Lai J: "In openly siding with [the Hong Kong company] in its dispute with the plaintiff, the defendant, who wears two hats as a director of both companies… is clearly acting in conflict of his duties as the plaintiff's director".]

What should a director do when there is a conflict of duty and interest? He or she could either abstain from voting or deciding on the issues, or he could resign. Is there a 3rd option, that is the nominee's duties are adjusted. This can arise when there is attenuation of duties to match the "interests of the company". Ideally, the recalibrated duties should be reflected in the shareholders' agreement. However, even if this is not done, it is possible to find evidence that the parties intended such recalibration to take place when circumstances change.

In Golden Village, might it be argued that Mr Poon's duties have been adjusted?

Next, the case of Chang Betty v Tang Kin Fei (Sembcorp Saga) touches on procedural irregularities:

[Facts of the case]

In the High Court, Woo Bih Li J held that the resolutions to appoint solicitors to advise and act for PPLS were valid as these were "neutral and in the interest of [PPLS]". The learned judge held, however, that those resolutions which instruct the solicitors to investigate SCM's allegations and to advise PPLS how to respond to these allegations appear "one-sided" as they suggest an assumption that the proposed investigation was indeed in PPLS' interest. On appeal, the Court of appeal, in a judgment delivered by Andrew Phang JA, was of the view that, as the validated resolutions effectively overrode the agreement between the parties as to the scope of Wong Partnership's role by giving the latter an enlarged role, this constituted substantial injustice to the appellants. The appeal was accordingly allowed.]

What is interesting here is that the directors are ones complaining and relying on the deadlock rights. The accusation here is breaches of directors' duties, which concern all the shareholders. This case should have been decided the way the High Court decided.

The 3rd issue I wish to discuss is the oppression remedy codified under s 216 of the Singapore CA. This section is couched in very wide terms: oppression; disregard of shareholder's interest, unfair discrimination; prejudice. Case law has shown that the court will consider all the limbs together and the main premise is that of unfairness.

The issue of whether a quasi-partnership can arise in a JV situation was discussed in Over & Over v Bonvests Holdings:

[Facts of the case and decision]

What is interesting here is that the court found that the JVC was a quasi-partnership. The family members involved were not known to each other and were businessmen. They were holding separate businesses. Yet, the court found that there was a quasi-partnership based on the fact that there was nothing formal agreed between the parties. It is interesting that the court looked behind the corporate veil to find out what the parties' relationships really are.

Finance, Property and Business Litigation in a Changing World

Concurrent Session 3D: Maritime Insolvencies

Speakers

Ms Catherine Newman QC, *Maitland Chambers*

Mr Toh Kian Sing SC, *Rajah & Tann LLP*

MARITIME INSOLVENCY

A SINGAPORE LAW PERSPECTIVE

TOH KIAN SING, SC
Head of Shipping and Admiralty
Rajah & Tann LLP

INTRODUCTION

- **Law of corporate insolvency and admiralty law do not go together.**
- **There are 3 reasons for this incongruence.**

WINDING UP IN SINGAPORE

- Compulsory winding up
  - Section 262(3) Companies Act : moratorium for compulsory winding up unless leave of Court is given.
  - Winding up of a shipowning company / issuance of a writ prior to winding up order confers secured creditor status on a maritime claimant.
  - Re Aro [1980] 1 Ch 196
  - Lim Bock Lai v Selco [1987] SLR(R) 466
  - The Hull 308 [1991] 2 SLR(R) 643

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WINDING UP IN SINGAPORE

- Voluntary winding up
  - Section 299 Companies Act : moratorium for voluntary winding up unless leave of Court is given.
  - The Oriental Baltic [2011] 3 SLR 487: filing of a caveat against release not sufficient.
  - The Engedi [2010] 3 SLR 409: no leave required to commence foreign arbitrations against a company in a voluntary winding up. The Court may, however, have the power to refuse to uphold an award or restrain the arbitration via an anti-suit injunction. *Quaere* status of decision as appeal was allowed with no written grounds.

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CHANCERY BAR

FINANCE, PROPERTY AND BUSINESS LITIGATION IN A CHANGING WORLD

FOREIGN WINDING UP

- Arrest of a vessel belonging to a foreign shipowner which is under liquidation.
  - There should be no bar to arrest unless (perhaps) the two states involved are signatories of the Model Law on Cross Border Insolvency. But the Model Law does not deal specifically with admiralty procedure.
- Dissolution of a foreign company.
  - Kuo Fen Ching v Dauphin Offshore [1999] 2 SLR(R) 793: self-destruction of a shipowner.

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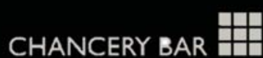

BENEFICIAL OWNERSHIP AND WINDING UP OF A SHIPOWNING COMPANY

- Section 4(4) of the High Court (Admiralty Jurisdiction) Act: requirement of beneficial ownership.
- The Convenience Container [2006] 4 HKC 435: beneficial ownership not divested by winding up.

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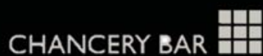

FINANCE, PROPERTY AND BUSINESS
LITIGATION IN A CHANGING WORLD

BENEFICIAL OWNERSHIP AND WINDING UP OF A SHIPOWNING COMPANY

- Is there a reason to treat the maritime claimant differently and preferentially compared with the non-maritime claimant?
  - The Ship "Brussel" v Holt Cargo System [2001] 3 RCS 907: Combination of historical and policy reasons.

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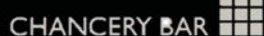

JUDICIAL MANAGEMENT / ADMINISTRATION / SCHEMES OF ARRANGEMENT / ANALOGOUS REHABILITATION PROCEEDINGS

- General moratorium against proceedings, including admiralty proceedings and maritime arbitration, unless leave of Court is given.
- Impact on arrested vessels.

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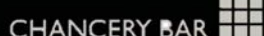

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FOREIGN REHABILITATION PROCEEDINGS

- Assistance of Singapore Courts not readily granted.
- Re TPC Korea Co Ltd [2010] 2 SLR 617: preemptive restraint order in aid of Korea Rehabilitation Order not allowed.

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LATEST WORD ON MARITIME INSOLVENCY FROM THE SINGAPORE COURTS

- Beluga Chartering GmbH v Beluga Projects & Anor [2013] SGHC 60.
  - Section 377(3)(c) Companies Act applies to the liquidation of unregistered foreign companies. It provides:

    "(3) A liquidator of a foreign company appointed for Singapore by the Court or a person exercising the powers and functions of such a liquidator —

    …

    (c) shall, unless otherwise ordered by the Court, only recover and realise the assets of the foreign company in Singapore and shall, subject to paragraph (b) and subsection (7), pay the net amount so recovered and realised to the liquidator of that foreign company for the place where it was formed or incorporated after paying any debts and satisfying any liabilities incurred in Singapore by the foreign company."

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FINANCE, PROPERTY AND BUSINESS LITIGATION IN A CHANGING WORLD

LATEST WORD ON MARITIME INSOLVENCY FROM THE SINGAPORE COURTS

- Beluga Chartering GmbH v Beluga Projects & Anor [2013] SGHC 60.
  - Section 377(3)(c) requires Singapore liquidators to transmit net proceeds to the principal liquidation, subject to Singapore preferential debtors and the satisfaction of debts incurred in Singapore.
  - Singapore Courts have a discretion under the common law ancillary liquidation doctrine to disapply obligations under the statutory insolvency regime.
  - This case is not an affirmation of the territoriality principle.

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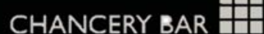

Verbatim Transcript of Concurrent Session 3D: Maritime Insolvencies

Catherine: I'm going to speak briefly about the UK perspective and some issues which might be relevant here, crossover between judgments regulations and insolvency regulations giving rise to case law.

In the uk shipping cases contributed to law of contract and procedural law, arbitration. In insolvency, shipping cases added considerably for cross-border issues. Entirely common for ship to be owned by company in one place, chartered in another, located in a third. Contracts English law, but arbitration, usually by english rules. Scene set for cross-border problems. General terms about cross-border principles.

Two main regulations to consider. First the judgments regulation, second the European council regulation on insolvency, togethwe with cross-border regulation give effect to uncitral modal law. Collective insolvency proceedings. Partial or total divestment of director and appointment of liquidator. Each eu state allowed to administer own procedures for insolvency. Broadly in UK corresponds to winding up, administration, voluntary arrangements. Doesn't include receivership – no supervison of court, individual proceedings. Important in practice to look at list and see whether proceeding is on list. If not on list, doesn't matter that it looks like insolvency proceeding – not covered.

Limited to debtors centre of business in EU. Centre of business can change, not about where it was registered, original law, etc. centre of main interest can move. Once established where centre of main interest, insolv proceedings usually begun there. Locus of main proceeding. Can also be ancillary proceedings in other jurisdictions. Law to be applied is principally the law of main proceeding. E.x. English company, owns ship in sg, extensive business elsewhere. Usual position is that main insolvency proceeding opens in England and assets of company subject to English law.

Frequently have to establish foreign insolvency procedures, to see if they fall within insolvency regs. And then competing claims about where main proceeding shoul be brought or not brought (anti suit injunctions are common). Generally the scope of the regulation extends to collective process for administration of assets. Statutory stay of proceedings has no extraterritorial effect. Foreign claimants can carry on in other jurisdictions, ignore stay. Charterer might default, ship in france, if creditor can arrest in france prior to opening of insolvency, all claims generally have to be brought in main juris, and see what regulation it's governed by. Claim about preference (avoidance) is going to be brought by liquidator, jurisdiction of main proceedings, wherever defendant is. Easy to get permission to serve out. Creditor will either have to submit to proceedings in main juris, or will face default judgments.

In contrast with collective claims, foreign claims under general law e.x. misrep claims fall under judgments regulation. Once judgment started, court first seized gets to decide whether to retain the claim. Can create delays in adjudication of claims. Sometimes particular jurisdictions chosen by litigants for how slow it is. ("the Italian torpedo" – claim gets holed below the water and delayed many many years)

So a lot of fighting over procedure before getting to the merits of the claim. Some litigants can take advantage, can be frustrating to others.

The Yacht Bull [2010] – Madoff yacht. Registered to cayman SPV. Company thought to be controlled by mrs Madoff. US citizen and resident. Yacht bought with English Madoff securities money, controlled by mr Madoff. Madoff company was being wound up in uk, liquidators appointed. French creditor who lost 10m euros arrested the yacht. Fight between liquidators and French creditor. Applications to discharge French arrest, reinstate, etc. two arrests at one point. Liquidators applied in England to try to stop French creditor from pursuing claims. But dispute about who owned yacht – French creditor said cayman company owned it, English liquidator said Madoff England owned it. Beneficial interest claimed but not proven – problem. Who owned the ship? French creditor argued claim was individual claim, not insolvency claim. English court agreed. Insolvency regulation didn't apply, so French court had jurisdiction (brought there first).

Another point – in relation to arbitrations. Quite a lot of jurisprudence arising out of armada shipping. Main centre is Switzerland, but proceeding recognised in a number of other countried. One case. Owner chartered, sub-chartered, owner had lien on sub-hire. Charterer defaulted, owner exercised lien. Dispute about who was entitled to the hire. Two arbitrations. One against sub-charterer in England, sub-charterer started one against armada. Arguments about who was first. Court decided to look at what the real issue was. Real issue was competing claim against sub-hire. Irrevocable agreement in contract for arbitration – so they had to go to arbitration for that claim, not the insolvency proceeding. Insolvency proceedings don't always override.

Toh Kian Sing:

Interplay between insolvency law and admiralty. These areas don't go well together but very often they come into a collision course. Two competing regimes – insolvency regime and an admiralty action.

Admiralty and insolvency law developed along different paths. Draftsmen of statutes haven't consulted with each other. In companies act, language has no bearing with admiralty law, but when company goes insolvent, asset of company – vessel – have to be dealt with under one or both regimes. Always a tension between these two regimes. Idea behind admiralty is that vessel can be arrested, sold, pay off a certain class of creditors. You take the asset outside the general pool of creditors, another set of creditors unhappy.

If I can illustrate this with a few themes. The first is a winding up of a company. If a company is wound up, admiralty claimant who has a writ out before the start of winding up, get security. Court will give leave. Like a bank, even if only a bunker supplier. But if slow in getting writ out, treated like unsecured creditor. This principle has been applied in compulsory winding up. But in a case decided recently – oriental Baltic – court extended principle to voluntary winding up. Importance of issuing right early. Ship was under arrest, other claimant showed up. But only filed a caveat against ship and didn't issue writ. Shipowning company subject to VWO, commenced by shareholders resolution in morning of that day. Claimant found out, issued writ on same day. But court said leave to continue would not be granted. Also interesting to note that in many of these cases, if writ issued in time and vessel arrested, culminate in judicial sale of vessel. CA 260 – when winding up commence, execution, sequestration, etc is void.

Doesn't sit well in admiralty. That provision is effectively disapplied when your writ is in time. Admiralty procedure is carveout from general insolvency procedure. Let me move on to slightly different situation where arrest takes in sg but owner is being liquidated elsewhere. Normally there's no bar. Unlike in uk, sg not signatory to model law. Not constrained by moratorium. The model law doesn't have anything specifically to deal with admiralty.

Even if foreign company wound up in due course, doesn't frustrate admiralty process in sg. Winding up of foreign company doesn't prevent sg court from granting admiralty judgment, distributing proceeds. Some years ago COA decided very important case – Kuo Fen Ching v Dauphin. Company self-destructed. Wound up in one of those flags of convenience. Notwithtstanding this, default judgment obtained.

Moving on to slightly different issue but same theme. Those of you practicing in the shipping bar know about the requirement for beneficial ownership of the vessel before arrest. 30 years ago HL judgment where lord diplock said that assets not beneficially owned by company in WU – company divested of beneficial ownership. If that is the case, every time company is wound up, provision under 4(4) in HC(AJ)A disapplied – can't arrest the vessel if company has been wound up. That very issue came before hong kong courts in "the convenience container". Involved a sg vessel owned by a sg lawyer. What was interesting was after all evidence on sg law provided to hk judge, aust HC came up with a very significant decision, tax case. Took a very different position – HK court said more sensible to say that beneficial ownership not divested just because company wound up, arrest allowed. You see the interplay between insolvency law and admiralty law and once against admiralty law comes out tops. If vessel is sold, proceeds of sale distributed by insolvency rules. But in admiralty taken out of the general pool. Consider a bank in proceeds of ship been judicially sold. Bank comes after the salvor, who would normally be an unsecured creditor. Bank comes after crew. You can see that admiralty operates under completely different regime compared with insolvency law.

Take a step back and ask ourselves –should admiralty claimants be treated separately from other claimants? Speaking from perspective of admiralty lawyer, yes. Glad to see that the position I take is somewhat supported by "brussel", Canadian supreme court decision. Brings into play the sharp focus between insolvency and admiralty. Liquidation took place in belgum, went to Canadian court, tried to persuade Canadian courts to issue certain orders to stay admiralty proceedings in Canada. Bankruptcy judge exercised jurisdiction, but Canadian supreme court said no, must allow admiralty proceedins to continue. Why? Two reasons. Firstly historically admiralty courts operated in own sphere. Secondly underlying policy reason. Ships ply all over the world, could be incorporated in some remote jurisdiction. Owners opaque, difficult to trace ownership, ship easy to evade creditors once sailed out, so you need to give creditors comfort of security. Must allow them to arrest the ship, otherwise no one would extend credit to shipowners. If you mix the two together – don't keep admiraly separate – maritime commerce severely curtailed. Admiralty judge in Australia agrees. Quite a great degree of acceptance of policy reasons for treating maritime claims differently.

Let me move on to JM, schemes, rehab proceedings.

Again you know that when there's a JM there's a genera moratorium, covering admiralty proceedings and arbitration. You can lift this if you go to court and get an order to that effect, but what's interesting is that it's largely unexplored. If you for example have a company just brought under JM, one of its vessels under arrest, moratorium steps in. what do you do? Apply to release the vessel? What about situation where judicial order for sale granted? Apply to court to set aside? Allow sale but retain proceeds? Allow sale and pay out to claimants? Significant questions that common law jurisds haven't come to grips yet. Important to deal with as more maritime companies go under in this part of the world.

Slightly different but somewhat analogous situation of foreign rehab proceedings. Chapter 11 proceedings against a shipowner. Set of proceedings analogous to chapter 11. Question sg court confronted with – should lend assistance to foreign rehab proceedings? Re tpc korea [2010]. In the nature of maritime commerce so many juris, systems of law could be involved. In re tpc korea bulk carrying vessel, number of vessels plying regularly into sg port. Owners of vessels subjected themselves to rehab proceedings, analogous to chapter 11. Korean shipowner applied to sg ex parte asking for restraint order preventing arrest of vessels in sg. Pre-emptive – no vessels in port when order asked for. Apart from these vessels plying sg waters, no connection with sg whatsoever. You can see how the shipowner is trying to forumshop by getting a restraint order to allow ships to ply waters. Singapore courts said we can't help you, this is a foreign rehab application, local creditors may be sucked into your rehab proceedings. So we're not going to extend our assistance to you. In any event, court made interesting observation – allowing such an order disrupts statutory order for local assets to pay local creditors. criticism that this is attempt by sg to apply territorial approach to international insolvency. Also the case of Beluga. Good indication of how SG courts will deal with foreign, foreign unregistered company. Shipping company wound up in Germany. Sum of money owned to it in Singapore – local assets, receivable. Liquidator wanted to remit it to Germany. Principal liquid in germany, ancillary in sg, liquidators applied to remit funds. Such an application confronted with 377(c) CA need to ringfence liabilities incurred in sg, then remit balance overseas. This provision, apparently is only found in sg and Malaysia. (Andrew chan, Catherine: not really, some other countries have it. But more limited). Okay. But general provision like this only in sg and Malaysia. Court said that court has discretion to disapply this provision in appropriate case where justice of case and public policy applies. But on the facts of beluga, transmission order not made. Should also point out that it's going on appeal. Latest word but not the last word.

Andrew Chan:

Just give me a few minutes. The whole point about the statutory trust that arises for benefit of creditors is that it's a trust. Secured creditors. But I don't see it as inconsistent with insolvency law. Maritime liens also security. Moving on to jm, true that it hasn't worked out yet, but principles are there. All these admiralty are security rights. Courts balance interest of security against purposes of administration. If no prejudice to security holder, prevent. If courts think company is insolvent. Long and short of it, establish principles should be okay.

On TPC korea. Proceeded under 210 CA. Power can only be exercised if company could have been wound up in Singapore. Sufficient connection to SG. Very much jurisd to wind up foreign company. Ex parte. Counsel didn't bring up that the threshold wasn't high. UK case law – sufficient connection if can get a clawback.

I'd like to think that if the matter were fully argued, it would have been different. Cambridge gas principles, recognition of foreign orders recognised here.

On Beluga, great concern among banks, people who set up personal investment companies. If it can hit all foreign companies including unregistered, can hit everyone. Judge points out that it's overinclusive, but says that they are limits. One of them is whether company could have been wound up under 351 – sufficient connection. Comfort I've been giving clients is that company is that this only applies if there's a local winding up.

Catherine:

I agree that contradictions not quite as serious as we think. In every insolvency, tension between tension, duty, desire to protect collective scheme, and indiv creditors. Remedies like arrest channel assets differently, special admiralty rules come into play. Desire is the same – individual creditor wants to get more.

One thing I'd like you to mention more – issuance of writ turns them into a secured creditor. What happens if there's a challenge to their writ?

TKS:

If writ set aside, then that person treated as thought they're not an admiralty claimant. Effectively void.

Audience:

Oddity about word 'lien' in maritime context. We're going to need a review. Starts off with unpaid seaman treated that they had a lien, but they didn't possess. Only way they could get their rights.

Andrew:

Employment Act SG – people who work on a property have priority over proceeds of sale by court. Even outside admiralty, we have other priorities.

Audience:

A lot of talk about abolishing ringfencing. Suggesting in article by local professor that shipping industry that needs to be ringfenced – if abolishing ringfencing, should keep ringfencing for this?

TKS:

Echoes point made by Canadian court. Maritime commerce carried out against unusual set of premises. Need that security for people who deal with shipping companies. Not that the two areas are conflicting, but better way to say it/describe it is that admiralty law is a carveout from general insolvency law.