

BVI analysis of a share allotment in breach of fiduciary duty

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The allotment of shares by directors affects the constitutional balance of a company. The exercise of this sensitive power is therefore subject fiduciary duties.

The duty to exercise powers for a proper purpose; and the duty to act honestly and in good faith in the best interests of the company were both recently considered by the BVI Commercial Court in IsZo Capital LP v Nam Tai Property Inc & Ors (3 March 2021) [1].

In Nam Tai, the Court considered the exercise by directors of their power under the Articles of Association to allot shares that resulted in the board allotting shares to one shareholder effectively preventing the other shareholders proceeding with a requisitioned meeting to consider changing the board.

Introduction: the power to allot shares

The power to allot shares is subject to fiduciary duties[2] and has long been recognised as a particularly sensitive power: see for example Ampol Petroleum Ltd v R.W. Miller (Holdings) Ltd[3] per Street CJ:

“It is always a delicate exercise for directors to issue shares. Particularly is this so where an issue is made otherwise than on a basis of equality to existing shareholders. Even more particularly is this so where the issue is made otherwise than to existing shareholders, and in a situation in which it is foreseeable that there can be real prejudice to existing shareholders or an identifiable group of existing shareholders.”

This proposition was reinforced by the Privy Council dismissing an appeal from the decision of Street CJ:

“Just as it is established that directors, within their management powers, may take decisions against the wishes of the majority of shareholders, and indeed that the majority

of shareholders cannot control them in the exercise of these powers while they remain in office (Automatic Self-Cleansing Filter Syndicate Co. Ltd. v. Cuninghame [1906] 2 Ch. 34), so it must be unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. To do so is to interfere with that element of the company's constitution which is separate from and set against their powers." [4]

The Eastern Caribbean Court of Appeal has consistently taken the same position. In Independent Asset Management Company Ltd v Swiss Forfeiting Company Ltd[5], Webster JA held at [25]:

"The foundation of the proper purpose rule lies in the fact that a company is divided into two basic organs: the board of directors and the shareholders. Directors are responsible for managing the business and affairs of the company and have the power to issue the shares as a part of that responsibility. In doing so, they must ensure that a proper balance is maintained between the two organs of the company...

In the situation described by Lord Sumption [in Eclairs Group Ltd v JKN Oil & Gas plc and others], where there is a power struggle between different groups of shareholders, the directors should not issue additional shares in such a way as to affect the balance of power in the company or influence in any way the outcome of shareholders' resolutions, even if this results in additional capital or other benefits for the company"

This is also an action that properly lies with the aggrieved shareholder directly against the company. The memorandum and articles of association are a statutory contract between shareholders and the company[6]. Hoffman J (as he then was) in Re a company (No. 005136 of 1986)[7] explained this:

"Although the alleged breach of fiduciary duty by the board is in theory a breach of its duty to the company, the wrong to the company is not the substance of the complaint. ... The true basis of the action is an alleged infringement of the petitioner's individual rights as a shareholder. The allotment is alleged to be an improper and unlawful exercise of the powers granted to the board by the articles of association, which constitute a contract between the company and its members. These are fiduciary powers, not to be exercised for an improper purpose. ... An abuse of these powers is an infringement of a member's contractual rights under the articles."

Proper purpose

In Antow Holdings Ltd v Best Nation Investments Ltd[8], Pereira CJ made the point succinctly, at [43]:

"It is well-established that directors cannot use their powers to perpetuate their or their

friends' control of their company."

This principle was developed in the common law, but has statutory force in the BVI by s121 Business Companies Act 2004:

"A director shall exercise his powers as a director for a proper purpose and shall not act, or agree to the company acting, in a manner that contravenes this Act or the memorandum or articles of the company."

In Independent Asset Management Company Ltd[9], Webster JA referred to the finding of the trial judge that the substantial purpose of the allotment had been to transfer voting control, and held at [43]:

"This is an improper purpose within the meaning of section 121 [Business Companies Act] and the cases referred to above and it does not matter that the directors were influenced by other motives and reasons that may have been beneficial to the company as a whole or its remaining equity shareholder. However altruistic those motives and reasons may have been "[t]hat is not, in itself, enough."" (citing Howard Smith Ltd v Ampol Petroleum Ltd, at 838B)

The purpose of directors is assessed largely on a subjective basis. This does not mean that the assertion of a director of their motivation, genuine or not, is the end of the inquiry. As Pereira CJ observed in Antow at [25], there must be an objective overlay since, citing Hutton v West Corp Railway[10], *"otherwise you might have a lunatic conducting the affairs of the company ... in a manner perfectly bona fide yet perfectly irrational"*.

Further, as Pereira CJ observed in Antow at [45] *"A court will not accept in an unquestioning way a director's assertion that he acted bona fide when the facts might appear to suggest otherwise"*.

Jack J identified in Nam Tai at [70], p. 27:

"The subjective motivation of a director is a matter of fact. In determining that factual question, it is relevant to consider the effect of the decision and the extent to which the director was aware of the effect of the decision. The only means by which the averment of a witness of his own subjective intention can be tested is by examining the surrounding facts, including the actual and foreseeable results of the witness's decision, and considering what can be inferred of the subjective intention of the witness therefrom."

There are a number of further subsidiary issues that arise, including the position where some or all of the directors are innocent of the improper purpose but are persuaded by a person with an improper purpose. Jack J addressed this in Nam Tai. Whilst he found that the directors did have an improper purpose in effecting the placement (or PIPE) in giving one shareholder de facto

control of the company and defeating the requisition, he also found at [165] that if he was wrong in that conclusion:

"... that this case came squarely within the scenario depicted by Mr Rosen QC in para [137] of Re Last Lion Holdings Ltd[11]. Dr Tam [the chairman who abstained on the vote] would have led the four directors into thinking that there was a proper purpose for the PIPE, namely a liquidity crisis which did not in fact exist."

At [137] Re Last Lion Holdings Ltd. [12] Murray Rosen QC concluded:

"It would be bizarre to uphold a decision in which a majority of directors went along with the director acting for an improper purpose, without exercising any independent judgment – or indeed in my judgment, because they had been deceived or were careless. Whether or not they can be said to have 'shared' the improper purpose in those circumstances is an unnecessary (and possibly confusing) additional formulation"

Duty to act fairly between members

s120(1) Business Companies Act provides:

"Subject to this section, a director of a company, in exercising his powers or performing his duties, shall act honestly and in good faith and in what the director believes to be in the best interests of the company."

This duty includes the duty to act fairly as between different members: see for example Re Fraser & Chalmers Ltd[13] per Astbury J: *"All shareholders are entitled to equal treatment unless and to the extent that their rights in this respect are modified by the contract under which they hold their shares."*

More recently in Re Sunrise Radio Ltd[14], HHJ Purle QC identified that *"A rights issue may be motivated solely or mainly by the desire to raise further capital, yet still unfairly discriminate in its effect against one group of shareholders, including shareholders holding shares of the same class as other shareholders who are advantaged by the same exercise"*. In other words, even though an allotment is carried out for a proper purpose, it may still be in breach of fiduciary duty. At [95] HHJ Purle QC held:

"What is clear to my mind, however, is that the fiduciary nature of the power requires a board to consider these matters fairly, in the interests of all groups of shareholders and having regard to the foreseeable range of responses. The impact of that duty may be more acute if the board members, or those in a position to control or influence them, stand to benefit appreciably from the exercise of the power in a particular way."

The result is that directors are required to give proper consideration to the interests of different shareholders. In Re BSB Holdings Ltd (No. 2) [15], Arden J (as she then was) held that, pursuant

to the duty to act fairly as between different shareholders, the directors were required to:

“address their minds to the question whether the proposals had different effects on different groups of shareholders and, if they did, whether this was authorised by the contractual arrangements between the parties or was justified in the particular circumstances by the overriding need to act in the interests of the company.”

s120(1) therefore provides two hurdles for directors effecting an allotment of shares: first, they must act honestly and in good faith and in what the directors believe to be in the best interests of the company; and secondly, the directors must give proper consideration to the interests of members excluded from the allotment. In Nam Tai, the directors fell at the first hurdle, Jack J finding at [166]:

"In addition, it follows that the directors did not act *bona fide* in order to save Nam Tai for the benefit of all the shareholders. On the contrary they acted for the benefit of Kaisa. That is in my judgment a breach of section 120(1) of the [Business Companies] Act."

Conclusion

Directors effecting placements of shares are exercising a power that is recognised by the courts both in England and the BVI as particularly sensitive, since the power goes to the constitutional balance of the company.

The power exercised for an improper purpose is likely also a breach of the duty to act honestly and in good faith and in what the director believes to be in the best interests of the company. Conversely, the exercise of the power in good faith and for a proper purpose may still be a breach of duty if proper consideration is not given to the interests of excluded shareholders.

In Nam Tai the Judge did not have to consider this last hurdle having found that the directors acted both for an improper purpose and not in good faith for the benefit of all shareholders.

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Part of the Ogier team representing IsZo, also included Ewelina Clyde-Smith and James McDermott.

[1] BVIHC (COM) 2020/0165

[2] See eg Independent Asset Management Company Ltd v Swiss Forfeiting Company Ltd BVIHCMAP 2016/0034 per Webster JA at [24]

[3] [1972] 2 NSWLR 850 at 881B

[4] Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821 per Lord Wilberforce at 837F. See also Eclairs Group Ltd v JKX Oil & Gas plc and others [2015] UKSC 71 per Lord Sumption at [16]: “One of the commonest applications of the principle in company law is to prevent the use of the directors’ powers for the purpose of influencing the outcome of a general meeting. This is not only an abuse of a power for a collateral purpose. It also offends the constitutional distribution of powers between the different organs of the company, because it involves the use of the board's powers to control or influence a decision which the company's constitution assigns to the general body of shareholders.”

[5] BVIHCMAP2016/0034

[6] s11 Business Companies Act 2004

[7] [1987] BCLC 82 at 84d-f

[8] BVIHCMAP2017/0010

[9] BVIHCMAP2016/0034

[10] (1883) 23 ChD 654 at 671

[11] Also known as Otello Corp ASA v Moore Freres & Co [2018] EWHC 2347 (Ch)

[12] [2018] EWHC 2347 (Ch)

[13] [1919] 2 Ch 114, at 120

[14] [2009] EWHC 2893 (Ch) at [82]

[15] [1996] 1 BCLC 155 at 251

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