THE EASTERN CARIBBEAN SUPREME COURT

IN THE COURT OF APPEAL

TERRITORY OF THE VIRGIN ISLANDS

BVIHCMAP2016/0034

BETWEEN:

INDEPENDENT ASSET MANAGEMENT COMPANY LIMITED

Appellant

and

SWISS FORFAITING LTD

Respondent

Before:

The Hon. Dame Janice M. Pereira, DBE — Chief Justice
The Hon. Mr. Mario Michel — Justice of Appeal
The Hon. Mr. Paul Webster — Justice of Appeal [Ag.]

Appearances:

Mr. Jonathan Crow, QC, and with him, Mr. Jonathan Addo for the Appellant
Mr. Christopher Parker, QC, and with him Ms. Arabella di Iorio and
Mr. Simon Hall for the Respondent

2017: July 12;
November 24.

Commercial appeal – Powers of directors in issuing shares – Whether issuance of shares by directors for a proper purpose – Proper purpose rule – Whether honest intentions of directors is a relevant consideration

The respondent is a British Virgin Islands company that operated as an open-ended mutual fund which specialised in investments in the field of forfaiting ("the Fund"). The Fund issued two classes of shares. The class A shares carried all the voting rights but did not entitle the holders to participate in the profits of the Fund nor in any distribution of its assets on a winding up. The class B shares carried no voting rights but shared in the profits and in the assets on a winding up.

The Fund was set up by Mr. Rinaldo Invernizzi and Mr. Salvatore Chiappinelli. Mr. Invernizzi held the majority of the B shares through his company SIX SIS AG.

The appellant is a Hong Kong registered company and was, up to July 2014, the sole class A shareholder of the Fund holding 100 A shares. The appellant was also the Fund's investment manager pursuant to an investment management agreement dated 8th January 2007. Mr. Chiappinelli owns SFC Swiss Forfaiting Company Ltd ("SFC") and through it, he managed the Fund.

As a result of the Fund deciding to migrate to Luxembourg in 2008 and a requirement under Luxembourg law that its manager be Swiss, the Fund did not require the appellant's services. The appellant applied to the Hong Kong Companies Registry to be de-registered. The application was granted and the appellant was dissolved on 30th December 2011.

The Fund wrote to the British Virgin Islands Financial Services Commission ("the Commission") advising, among other things, that it no longer intended to migrate to Switzerland, that it had suspended the payment of redemption proceeds, and that it intended to liquidate the Fund's investments. The Commission requested certain information which was only available from the appellant. Despite several requests for this information, there was no response from the appellant except a request for payment of certain unpaid invoices.

By this time, there was a break down between the Fund and Mr. Chiappinelli and a reorganisation plan was devised to deal with the impasse. The plan noted that the Fund desired to issue 500 class A voting shares to CTS Nominees Ltd.

On 10th July 2014, the directors of the Fund passed a resolution approving the issue of the 500 class A voting shares to CTS Nominees Ltd which shares were transferred to Sunimar Private Ltd, a Singaporean company beneficially owned and under the control of Mr. Invernizzi. The appellant's voting share was therefore reduced from complete voting control of 100% to a minority position of 16.67%.

On 10th July 2014, the Fund commenced legal proceedings against SFC in Switzerland to recover sums estimated at €8.3 million held by SFC on trust for the Fund ("the July Issuance").

The appellant was restored to the Register of Companies in October 2014 and on 24th April 2015, the appellant filed its claim in the Commercial Court seeking orders under sections 184I and/or 184B of the British Virgin Islands Business Companies Act ("the BC Act") declaring the July Issuance unfairly prejudicial and/or in breach of the provisions of the BC Act, and setting aside the July Issuance. In dismissing the claim, the judge found that in issuing the 500 A class voting shares the directors were not acting for an improper purpose. They were seeking to ensure that the new shareholder had effective control of the Fund and that the appellant could not retake control and use its controlling power to thwart the Fund's claim against SFC in Switzerland and/or block its defence of any claim by SFC for unpaid fees. The July Issuance was therefore not unfair nor in breach of the provisions of the BC Act. The judge noted that even if he had found that the July Issuance

was wrongful, he could not rescind the issuance of shares because the owner of the shares, Sunimar Private Ltd., was not a party to the proceedings.

In this Court, the appellant advanced that the July issuance was made by the directors for an improper purpose and was therefore in breach of section 121 of the Business Companies Act. The appellant argued that, inter alia, the judge did not follow the correct procedure in determining whether the directors acted for a proper purpose; that the judge should have held that the only purpose of the July Issuance was to dilute the appellant's shareholding; and that the judge erred in finding that the July Issuance was done for management purposes. The respondent argued that since the appellant did not plead a proper purpose for issuing the shares, it could not succeed on this issue and; that since the July Issuance occurred when the appellant was defunct, the investment management agreement was a "dead letter" and the shares were issued to prevent the appellant influencing the litigation to the detriment of the Fund. This, they say, justified the judge finding that the directors were not acting for an improper purpose.

Held: (1) allowing the appeal and setting aside the order of the learned trial judge in the court below; (2) declaring that the issue of the 500 A class voting shares to CTS Nominees Ltd on 19th July 2014 was done in breach of section 121 of the Business Companies Act; and (3) awarding costs of the appeal and in the court below to the appellant, such costs to be assessed if not agreed within 21 days of the date of this order, that:

1. 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.

   Eclairs Group Ltd v JKX Oil & Gas plc and others [2015] UKSC 71 considered.

2. 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 restriction is not written into the company's articles and it for this reason that equity imposes on the directors the additional requirement that the shares must be issued for a proper purpose. If the directors issue shares for an improper purpose, the issue is liable to be set aside. The fiduciary obligation to issue shares for a proper purpose was incorporated in section 121 of the Business Companies Act.

   Hogg v Cramphorn Ltd [1967] Ch. 254 considered; section 121 of the British Virgin Islands Business Companies Act 2004 considered.

3. The fiduciary duty that is impressed on the directors to issue shares for a proper purpose is not minimised in any way if the shares that are being issued do not

have a proprietary interest in the company and are not being issued for the purpose of raising capital. The rationale behind the proper purpose rule is that directors should not issue shares in a manner that could affect the balance of power between groups of shareholders in the company or create new majorities. This is exactly what happened in this case: the directors created a new majority by the July Issuance, and it does not matter for the proper purpose rule whether the old or the new majority did not have a proprietary interest in the Fund.

4. The basic rule is that the directors' purpose, however noble, should not be used to affect the balance of power in the company. If it is used in this way, it is an improper use of the power and is liable to be set aside.

5. The trial judge having found that the substantial purpose was to create a new majority, the July Issuance cannot be saved by the directors' honest intention of trying to protect the Fund from the potential of having the appellant on both sides of the litigation in Switzerland. Further, the learned trial judge made a finding that the substantial purpose for the July Issuance was to take control of the voting power of the Fund from the appellant and hand it over to companies controlled by Mr. Invernizzi. This is an improper purpose within the meaning of section 121 of the Business Companies Act 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."

Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co. Ltd. (1968) 121 CLR 483 applied; Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 82 applied; section 121 of the British Virgin Islands Business Companies Act 2004 applied.

JUDGMENT

[1] WEBSTER JA [AG.]: This appeal considers the powers of directors in issuing the shares of a company incorporated and existing under the British Virgin Islands Business Companies Act[1] ("the BC Act").

Background

[2] The respondent is a British Virgin Islands company that operated as an open-ended mutual fund ("the Fund"). The Fund specialised in investments in the field of forfaiting which is a method of trade finance involving investments in exporters' receivables. The Fund issued two classes of shares. The class A shares carried

[1] No. 16 of 2004.

all the voting rights but did not entitle the holders to participate in the profits of the Fund nor in any distribution of its assets on a winding up. The class B shares carried no voting rights but shared in the profits and in the assets on a winding up.

[3] The Fund was set up by Mr. Rinaldo Invernizzi and Mr. Salvatore Chiappinelli. Mr. Invernizzi was a wealthy investor who contributed most of the capital and held the majority of the B shares through his company SIX SIS AG ("SIX"). Class B shares were also issued to other investors in the Fund. Mr. Chiappinelli was an expert in forfaiting and contributed his expertise.

[4] The appellant is a Hong Kong registered company and was, up to July 2014, the sole class A shareholder of the Fund holding 100 A shares. The appellant was also the Fund's investment manager having been appointed pursuant to an investment management agreement dated 8th January 2007. Messrs. Chiappinelli and Invernizzi own 75% and 25% respectively of a Samoan company that wholly owns the appellant. As a class A shareholder, the appellant did not have a proprietary right or interest in the Fund's assets. It received its returns from fees charged for managing the assets and providing corporate services.

[5] The appellant appointed SFC Swiss Forfaiting Company Ltd ("SFC") as its agent to purchase securities and offer them to the Fund on a first refusal basis. SFC is listed in the Fund's private placement memorandum as its agent. SFC is owned by Mr. Chiappinelli and he performed the functions of managing the Fund through SFC.

[6] The corporate director of the Fund at all material times was CTS Management Limited which is a part of a group of financial service providers with expertise in the areas of fund administration, corporate finance and fiduciary management.

[7] The Fund performed well initially but by the end of 2008 its growth opportunities were being restricted by the worldwide financial crisis and the fact that it was

domiciled in the BVI. This led to a decision to migrate the Fund to Luxembourg. The BVI Financial Services Commission ("the Commission") was advised of the decision. Under Luxembourg law, the Fund had to have a Swiss manager. The Fund appointed a Swiss company, Farad Investment Advisers SA, as its new manager. From that point, the Fund did not require the appellant's services and on 12th August 2011, the appellant applied to the Hong Kong Companies Registry to be deregistered. The application was successful and the appellant was dissolved on 30th December 2011.

[8] By December 2012, the Fund had received numerous requests for redemptions by the B shareholders and on 1st December 2012, it suspended the redemption of its shares. On 19th December 2012, the Fund wrote to the Commission advising it that the Fund no longer intended to migrate to Switzerland, that the payment of redemption proceeds had been suspended and that the Fund was in contact with its shareholders regarding the preferred way of liquidating the Fund's investments. The Commission responded by letter dated 5th February 2013 requesting various items of information regarding the Fund. The requested information included details of the Fund's investments that were only available from the appellant. The Fund made several requests of the appellant to provide the information, including a letter from Fund's BVI lawyers, Maples and Calder, on 27th May 2013. The attempt to deliver the letter to the appellant's business place in Hong Kong failed because the appellant had moved out of the premises without leaving any information about a new or forwarding address. The letter was also sent by email. There was no response. What the Fund did receive from the appellant was invoices for sums in excess of €4.3 million for services provided by SFC to the Fund over a period of seven years. The appellant also claimed a further sum of €2 million which was paid to a company called IAMC in Panama which had nothing to do with the appellant.

[9] In January 2014, while contemplating court action against the appellant and SFC, the Fund discovered that the appellant had been dissolved since 30th December 2011.

[10] The position at this time was that there were two investors left in the fund, SIX and Citco holding 99% and 1% respectively of the class B shares; SFC held approximately €8 million on trust for the Fund which it was not releasing; SFC had a potential claim against Fund for unpaid fees; the appellant was dissolved and had not provided the requested information that the Fund needed to reply to the Commission's letter of 5th February 2013 and which was also needed to calculate the Fund's net asset value for the redemption of the outstanding shares.

[11] By this time, the relationship between Mr. Chiappinelli and Mr. Invernizzi had deteriorated and the atmosphere was pregnant with the possibility of litigation.

The reorganisation plan

[12] Between April and May 2014, the personal directors of the Fund's corporate director devised a reorganisation plan to deal with the impasse that had developed between the Fund and Mr. Chiappinelli and the impact that the dispute was having on the Fund. The draft reorganization plan noted that 100 class A shares had been issued to the appellant which had been dissolved in December 2011 and that the Fund desired to issue 500 class A voting shares to CTS Nominees Ltd "in order to ensure the control of the fund is not lost." The plan further stated that a directors' resolution would be necessary to amend the Fund's memorandum and articles of association to permit the issue of 500 class A shares to CTS nominees Ltd., and that once this was done "… the control of the Fund will rest with CTS Nominees Ltd, and the uncertainty regarding the shares held by IAMC will be lifted. The Register of Members of the Fund will then be amended." The reorganisation plan was circulated to the two remaining class B shareholders, SIX and Citco, for their approval. Mr. Invernizzi responded to the proposal by requiring that the 500 class A shares to be issued to CTS Nominees be transferred to a company under his control.

[13] On 10th July 2014, the directors of the Fund passed the resolution approving the issue of the 500 class A voting shares to CTS Nominees Ltd. The share certificate was issued to CTS Nominees and the share register of the Fund updated accordingly ("the July Issuance"). On 17th February 2015, the 500 class A shares were transferred to Sunimar Private Ltd, a Singaporean company beneficially owned and under the control of Mr. Invernizzi.

[14] The effect of the issue of the 500 class A voting shares was to reduce the appellant's voting power in the Fund from complete voting control of 100% to a minority position of 16.67%, and the new shareholder took control of the voting power of the Fund.

[15] Also, on 10th July 2014, the Fund commenced legal proceedings against SFC in Switzerland to recover sums estimated at €8.3 million held by SFC on trust for Fund. On 23rd March 2015, SFC filed and served its defence in the Swiss proceedings disputing the Fund's claim and exercising a right of retention of the monies claimed by the Fund against its own claim against the Fund for fees that it claims were owed to it by the Fund for services rendered. Mr. David Payne, a director of CTS Management Ltd and the only witness for the Fund at the trial, stated in his witness statement dated 5th April 2016, that the Swiss proceedings were relevant to the BVI proceedings because if the appellant succeeded in the BVI he would regain control of the Fund and would control both sides of the litigation in Switzerland. Mr. Payne believes that if this were to happen Mr. Chiappinelli would take control of the Fund, discontinue its claim in the Swiss proceedings and take control of the disputed funds in Switzerland for the benefit of his own companies to the detriment of the Fund's equity shareholder.[2]

[16] Subsequently, SFC filed a claim in the Commercial Court against the Fund claiming unpaid fees. A judge of the Commercial Court stayed the claim on the

[2] Paragraph 53 of his witness statement filed on 5th May 2016.

ground of forum non conveniens finding Switzerland to be the most appropriate forum for the trial of the claim. SFC's appeal to this Court was dismissed in July 2016 and it is not clear from the record if SFC is pursuing this claim in Switzerland or elsewhere.

[17] In October 2014, Bon Max Development Ltd., the sole shareholder of the appellant, applied to the Court of First Instance in Hong Kong to restore the appellant to the Register of Companies. The application was granted and the appellant was restored to the Register. The undisputed evidence is that upon restoration the appellant was deemed to have been in existence continuously as if it had not been dissolved. The learned judge found that the restoration application was precipitated by Mr. Chiapinelli becoming aware of the Swiss proceedings against SFC and the issue of the 500 A voting shares.[3]

The BVI claim

[18] On 24th April 2015, the appellant filed its claim in the Commercial Court seeking orders under sections 184I and/or 184B of the BC Act declaring the July Issuance unfairly prejudicial and/or in breach of the provisions of the BC Act, and setting aside the July Issuance. The claim also sought other relief which would only come into play if any of the main reliefs was granted.

[19] The action was heard by the learned judge from 7th - 9th June 2016 and he delivered a written judgment on 29th June 2016 dismissing the claim. In a nutshell, the judge found that in issuing the 500 A class voting shares the directors were not acting for an improper purpose. They were seeking to ensure that the new shareholder had effective control of the Fund and that the appellant could not retake control and use its controlling power to thwart the Fund's claim against SFC in Switzerland and therefore block its defence of any claim by SFC for unpaid fees. The July Issuance was therefore not unfair nor in breach of the provisions of the BC Act. In refusing the relief sought by the appellant, the judge noted that even if

[3] Paragraph 24 of the judgment.

he had found that the July Issuance was wrongful he could not rescind the issuance of shares because the owner of the shares, Sunimar Private Ltd., was not a party to the proceedings.

The appeal

[20] The appellant was dissatisfied with the judge's decision and appealed to this Court. The appeal does not challenge the judge's decision that the July Issuance did not produce any unfair prejudice to the appellant (the section 184I claim). The appeal is on the alternative basis that the July Issuance was made by the directors for an improper purpose and was therefore in breach of section 121 of the BC Act (the section 184B claim).

[21] The notice of appeal lists six grounds of appeal:

(i) Ground 1: the court did not follow the correct procedure in determining whether directors of the Fund had acted for a proper purpose in issuing 500 A shares in the Fund

(ii) Ground 2: The court should have identified a proper purpose for which the power to issue the shares had been delegated to the directors.

(iii) Ground 3: the judge should have held that the only purpose of the Fund's directors in exercising the power to issue the shares was to dilute the appellant's voting control.

(iv) Ground 4: The judge wrongly decided the case on a point that had not been pleaded by the Fund.

(v) Ground 5: The judge wrongly decided that the directors of the Fund were exercising the power to issue shares for management purposes.

(vi) Ground 6: The judge considered the question whether the directors were acting bona fide in the interests of the Fund, instead of deciding whether the power was to issue shares was exercised for a proper purpose.

[22] The grounds of appeal can be subsumed under one central issue in this case which the learned trial judge identified in the opening sentence of paragraph 43 of his judgment: "Ultimately, therefore, there is only one critical question: was the issuance done for a proper or an improper purpose?" Following the lead from the trial judge, I will deal with this appeal by considering the law relating to the issuance of shares for a proper purpose and then apply the law to the facts of the case.

The issuance of shares and the proper purpose rule

[23] The BC Act provides in section 45 that shares in a company are at the disposal of the directors. Section 45 reads -

> "Subject to this Act and to the memorandum and articles, shares in a company may be issued, and options to acquire shares in a company granted, at such times, to such persons, for such consideration and on such terms as the directors may determine."

The substance of section 45 is repeated in Article 16 of the Fund's Articles of Association –

> "Subject to the provisions of these Articles, the un-issued shares of the Company … shall be at the disposal of the directors who may, without prejudice to any right previously conferred on the holders of any existing shares or class or series of shares, by Resolution of Directors offer, allot, grant options over or otherwise dispose of them to such persons at such times and for such consideration, being not less than the par value of the shares (if any) being disposed of, and upon such terms and conditions as the company may by Resolution of Directors determine."

[24] Section 45 and article 16 reflect the basic principle of BVI company law that the directors of a company have the power to issue shares on such terms as they see fit. The usual purpose for issuing shares is to raise capital for the company but the cases recognize that the power can be used for other purposes so long as they

provide benefit to the company as a whole.[4] The cases also establish that the directors' power to issue shares is fiduciary in nature and it must be exercised for a proper purpose.

[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, and, as Lord Sumption said in Eclairs Group Ltd v JKX Oil & Gas plc and others:[5]

> "These considerations are particularly important when the company is in play between competing groups seeking to control or influence its affairs… The directors' task is no more difficult than it was in the many cases like *Howard Smith Ltd v Ampol Petroleum Ltd* in which other fiduciary powers, such as the power to issue shares, have been held improperly exercised because in the face of pressures arising from a battle for control the directors succumbed to the temptation to use their powers to favour their allies. I would agree with the majority of the Court of Appeal that in that situation the board would naturally wish to have the predators disenfranchised. That is precisely why it is important to confine them to the more limited purpose for which their powers exist. Of all the situations in which the directors may be called upon to exercise their fiduciary powers with incidental implications for the balance of forces among shareholders, a battle for control of the company is probably the one in which the proper purpose rule has the most valuable part to play."

In the situation described by Lord Sumption, 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 restriction is not written into the company's articles and it for this reason that equity imposes on the

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[4] See for example Lord Wilberforce in Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821 at page 836 referring to the Australian case of Harlowe's Nominees Pty. Ltd. v Woodside (Lakes Entrance) Oil Co. Ltd. (1968) 121 CLR 483.

[5] [2015] UKSC 71 at paragraph 37. See also paragraph 36 below.

directors the additional requirement that the shares must be issued for a proper purpose. If the directors issue shares for an improper purpose, the issue is liable to be set aside.[6] The fiduciary obligation to issue shares for a proper purpose was incorporated in section 121 of the BC Act which provides that -

> "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."

[26] The appellant submitted that the directors did not carry out the July Issuance for a proper purpose and it was therefore in breach of section 121 of the BC Act. As such the Fund is entitled to relief under section 184B which provides that -

> "If a company or a director of a company engages in, proposes to engage in or has engaged in, conduct that contravenes this Act or the memorandum or articles of the company, the Court may, on the application of a member or a director of the company, make an order directing the company or director to comply with, or restraining the company or director from engaging in conduct that contravenes, this Act or the memorandum or articles."

The Act does not provide any guidance as to what is a proper purpose for issuing shares. We must therefore resort to the case law which is helpful.

[27] Lead counsel for the appellant, Mr. Jonathan Crow, QC, invited this Court to approach the analysis of the proper purpose rule by following the four-step procedure that he applied sitting as a deputy judge of the High Court in England in Extrasure Travel Insurances Ltd and another v Scattergood and another.[7] The four steps are:

(i) Identify the power whose exercise is in question.

(ii) Identify the proper purpose for which that power was delegated to the directors.

(iii) Identify the substantial purpose for which the power was in fact exercised

[6] Per Buckley J in Hogg v Cramphorn Ltd [1967] Ch. 254 at 268-269;
[7] [2002] EWHC 3093 (Ch.) at paragraph 92.

(iv) Decide whether that purpose was a proper purpose.

Mr. Christopher Parker, QC who appeared for the Fund did not take issue with the correctness of the procedure suggested by Mr. Crow.

[28] Applying the procedure to the facts of this case, the first step of identifying the power being considered is simple – it is the power to issue shares, in this instance, the class A voting shares of the Fund.

[29] The second step is the reason for exercising the power. Shares are usually issued to raise capital for the company although shares may be issued for other purposes so long as the issue provides benefit to the company as a whole.[8] There was disagreement between counsel for the parties as to the purpose for issuing the class A voting shares. Mr. Crow contended that there was no difference between the class A shares and the class B shares – both classes were issued for raising capital. Mr. Parker submitted that the class A shares have no proprietary interest in the assets of the Fund and are not issued for raising capital but to distribute the voting power in the Fund. I deal with this issue below in paragraph 40 but suffice it to say for now that, in my opinion, it does not matter whether the class A shares were issued to raise capital or to distribute voting power. The central issue that I have to resolve is whether the shares were issued for a proper purpose.

[30] The third step is to determine the substantial purpose for issuing the shares. This was done by the learned trial judge when he found that the substantial purpose for issuing the class A shares was to transfer control of the voting power of the Fund from the appellant to a company controlled by Mr. Invernizzi. The Fund did not challenge this finding.

[8] See paragraphs 24 above and 41 below.

[31] The final step and the one that the learned judge described as the one critical question in this case is whether the shares were issued for a proper purpose. This is the issue that I will now analyse with the help of the cases.

[32] In Hogg v Cramphorn Ltd and others,[9] the directors of a company and their supporters held a minority shareholding in the company. In order to prevent an outsider from acquiring the entire issued capital of the company, the directors, in good faith and believing the avoidance of the acquisition by the outsider would be for the benefit of the company, devised a scheme the primary purpose of which was to ensure control of the company by the directors. They established a trust for the benefit of the company's employees and issued sufficient shares to the trust to create a majority of the shareholders on whose support they could rely. They also loaned funds to the trust which the trust used to pay for the shares. The directors' scheme was challenged by a shareholder and Buckley J decided that the entire scheme, including the issue of the new shares to the trust, was ultra vires the directors' powers unless ratified in a general meeting. He opined that the power to issue shares was a fiduciary power and if exercised for an improper purpose was liable to be set aside. It was immaterial that the issue was made in the bona fide belief that the scheme was in the interests of the company. The primary purpose was to ensure control of the company by the directors.

[33] The leading case on the proper purpose rule is Howard Smith Ltd v Ampol Petroleum Ltd,[10] a decision of the Privy Council from the Supreme Court of New South Wales. Two companies, A and B, owned 55% of the shares of the company M. Company M needed capital. Company A offered to purchase all the issued shares of company M. Another company, HS, announced its intention to make a higher offer for all the issued shares. Both A and B stated that they would refuse any offer to purchase their shares. HS then applied directly to M for an allotment of 4.5 million ordinary shares. The directors decided by majority vote to accept the

[9] [1967] Ch. 254.
[10] supra, note 4.

offer and immediately issued the shares to HS which provided much needed capital for the company. The effect of the issue was that A and B's majority shareholding was reduced to 36.6% and HS, as the new majority shareholder, was in a position to make an effective take-over bid. Company A challenged the validity of the issue of shares to HS. The directors of M contended that the primary reason for the issue of the shares to HS was to obtain much needed capital. At first instance Street J found that in issuing the new shares the directors were not motivated by personal gain or to retain their positions on the board, and that M needed capital. However, the primary purpose of the allotment was to dilute A and B's shareholding so that HS could proceed with the takeover bid. The learned judge held that the directors had exercised their powers improperly by issuing shares and he set aside the allotment. HS's appeal to the Privy Council was dismissed. In their Lordships' opinion, the directors, even if acting honestly, could not use their fiduciary powers to issue shares that had the effect of destroying an existing majority or creating a new majority, and since the directors' primary object was to alter the majority shareholding, this was an improper exercise of their powers. The opinion of the Board was delivered by Lord Wilberforce who said at page 837 –

> "So far as authority goes, an issue of shares purely for the purpose of creating voting power has repeatedly been condemned: Fraser v Whalley, 2 Hem. & M …"

And later on that page –

> "… so it must be unconstitutional for directors to use their fiduciary powers over the shares in the company for the purpose of destroying an existing majority or creating a new majority, which did not previously exist. To do this is to interfere with that element of the company's constitution which is separate from and set against their powers."

As regards the directors' honest intentions Lord Wilberforce said at page 838 –

> "Directors are of course entitled to offer advice, and bound to supply information, relevant to the making of such a decision, but to use their fiduciary power solely for the purpose of shifting the power to decide to whom and at what price shares are to be sold cannot be related to any purpose for which the power over which the share capital of the company was conferred upon them. That this is the position in law was in effect

> recognised by the majority directors themselves when they attempted to justify the issue as made primarily in order to obtain much needed capital for the company. And once this primary purpose was rejected, as it was by Street J., there is nothing legitimate left as a basis for their action, except honest behaviour. That is not, in itself, enough. "

[34] The Howard Smith case is a good example of how the proper purpose rule works. The majority of the directors were motivated by the need to bring in capital for the company but the trial judge found that their primary purpose was to dilute the shareholding of A and B so that HS could proceed with its takeover bid. The primary purpose involved affecting the balance of power in the company and was therefore an improper purpose and the allotment to HS was set aside notwithstanding the directors' honest belief in what they were doing.

[35] Mr. Crow, QC warmly embraced and adopted the principles in Hogg v Cramphorn and the Howard Smith case. He submitted that the directors' primary or substantial purpose in issuing the 500 class A voting shares to CTS Nominees Ltd. was to shift the voting power from the appellant to a company controlled by Mr. Invernizzi, and to do so in such a way that the control of the Fund would stay with Mr. Invernizzi's company. It did not matter that in doing so the directors may have been motivated by the desire to benefit the company as a whole by preventing the appellant from interfering in the Swiss proceedings.

[36] The learned judge did not accept these submissions. He noted that at the time of the July Issuance, and for more than two years before that, the appellant had been dissolved and therefore incapable of voting the 100 A shares that it held. The business of the Fund was at an end and the directors wished to take control from the appellant, a company that had been dissolved and therefore could not exercise the voting shares to achieve the winding up of the Fund. By shifting the power to CTS Nominees Ltd. and later Sunimar Private Ltd, they were putting the Fund in a position where it could wind up its affairs and make a substantial payment to the equity shareholders. The judge quite rightly went on to find that this was not the

only reason why the Fund was issuing the new voting shares to CTS Nominees. In paragraph 50 of his judgment, he made the following crucial finding:

> "It was not unnatural to fear that if [the appellant] was restored so that its control was resurrected, that control might be used to thwart the Fund in pursuit of its claim against SFC and in pursuit of its defence to SFC's impending claim for fees. That that was the substantial purpose for which the power to issue new shares was exercised is now clear and accepted by the Fund."

This is not just a finding by the judge that the substantial purpose for the July Issuance was to take control of the Fund from the appellant and transfer it to a new shareholder controlled by Mr. Invernizzi. It is also a finding that is based on a position, as the judge found, that was accepted by Mr. Payne in cross-examination.

The Fund's submissions on proper purpose

[37] Learned counsel for the Fund, Mr. Christopher Parker, QC, sought to justify the judge's finding that the July Issuance was not made for an improper purpose on several grounds.

[38] Mr. Parker, QC submitted that the judge having found that the appellant did not have a legitimate interest to protect by the proceedings and therefore did not qualify for relief under section 184I, and there being no appeal against this finding, the appellant could not succeed on the alternative claim under section 184B. I do not accept this submission. The considerations under a section 184I claim are not necessarily the same as the considerations under a section 184B claim. The latter is concerned in this case with whether the July issuance was for a proper purpose, not with whether the appellant had a legitimate interest to protect by the proceedings.

[39] Mr. Parker also raised a pleading point. He submitted that the appellant could not succeed on the proper purpose issue because it did not plead a proper purpose for issuing the shares. It is correct that the statement of claim does not use the

words proper purpose or set out a proper purpose. It states that the Fund wrongfully and unfairly diluted the appellant's shareholding by the July issuance in breach of the BC Act (paragraphs 5 and 6); that the dilution was unlawful and deliberate and part of the strategy to remove the appellant from any influence over the Fund (paragraph 7); and that the relief claimed included relief under section 184B of the Act. These averments, standing alone or combined with the appellant's written submissions, were sufficient to put the Fund on notice that it was facing a claim for issuing the 500 class A voting shares for an improper purpose.

[40] Mr. Parker further submitted that the purpose of issuing the 500 class A voting shares was not to raise capital as submitted by the appellant, but to confer voting control on a new shareholder. He relied on the judge's finding in paragraph 47 of the judgment that the class A shareholders do not have a proprietary interest in the Fund as illustrative of the fact that the A class shares were not issued to raise capital. In my opinion, it does not matter whether or not the class A shareholders have a proprietary interest in the Fund. The fiduciary duty that is impressed on the directors to issue shares for a proper purpose is not minimised in any way if the shares that are being issued do not have a proprietary interest in the company and are not being issued for the purpose of raising capital. As stated above, the rationale behind the proper purpose rule is that directors should not issue shares in a manner that could affect the balance of power between groups of shareholders in the company or to create new majorities. This is exactly what happened in this case: the directors created a new majority by the July Issuance, and it does not matter for the proper purpose rule whether the old or the new majority did not have a proprietary interest in the Fund.

[41] Mr. Parker also made points on the facts surrounding the issuance of the voting shares including the facts found by the judge. He submitted that the judge was correct to find that the July Issuance was made when the appellant was defunct, the investment management agreement was, to use the judge's expression, "a

dead letter",[11] and the shares were issued to prevent the appellant from influencing the litigation with SFC to the detriment of the Fund. The judge was therefore correct in making the further finding that the directors were not acting for an improper purpose. Mr. Parker's submission amounts to saying that notwithstanding judge's finding that the substantial purpose of the July Issuance was to create a new majority with controlling power, the fact that this was done to protect the company as a whole overrides the directors' improper purpose of creating the new majority, and the issuance is therefore proper. Mr. Parker relied on the decision from the High Court of Australian in Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co[12] which stands for the general proposition, with which I agree, that directors can issue shares for purposes other than raising capital for the company. However, the judgment of the High Court goes on to state that this is proper but only "…so long as these reasons relate to benefitting the company as a whole, as distinguished from a purpose, for example, of maintaining control of the company in the hands of the directors themselves or their friends." This case confirms the basic rule that the directors' purpose, however noble, should not be used to affect he balance of power in the company. If it is used in this way, it is an improper use of the power and is liable to be set aside.

[42] The Howard Smith case referred to above is even more instructive on how the Court should deal with the situation that obtains in this case, where there is a substantial purpose which is not, as a matter of law, a proper purpose, and a secondary purpose or motive of the directors which is for the benefit of the company as a whole. In Howard Smith, the Privy Council relied on the trial judge's finding that the substantial purpose for the issue of the shares was an improper purpose and that this could not be saved by the directors' honest intentions. In the passage cited above, Lord Wilberforce concluded by saying that: "And once this primary purpose was rejected, as it was by Street, J., there is

[11] The investment management agreement was never terminated.
[12] supra, note 4 above at 493.

nothing legitimate left as a basis for their action, except honest behaviour. That is not, in itself, enough." Similarly, in this case, the trial judge having found that the substantial purpose was to create a new majority, the July Issuance cannot be saved by the directors' honest intention of trying to protect the Fund from the potential of having the appellant on both sides of the litigation in Switzerland.

[43] Returning to the facts of this case, the learned trial judge, like the trial judge in the Howard Smith case, made a finding that the substantial purpose for the July issuance was to take control of the voting power of the Fund from the appellant and hand it over to companies controlled by Mr. Invernizzi. This is an improper purpose within the meaning of section 121 of the BC 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."[13]

[44] It would be very easy, and indeed tempting, to do as the trial judge did and uphold the directors' decision to issue the new shares to prevent what they saw as a real concern about the appellant retaking control of the Fund, and by so doing being able to influence the Swiss proceedings in a way that was adverse to the Fund's equity shareholder. However, the test is what is a proper purpose for the purposes of section 121 of the BC Act. Applying the rule in the Howard Smith case, once a court determines that the dominant purpose for the directors' decision is an improper purpose it does not matter what were the motives of the directors, however altruistic.

[45] In all the circumstances, I find that the learned judge erred in that, having found that the substantial purpose for issuing the 500 class A shares was to take control from the appellant and vest it in a company controlled by Mr. Invernizzi, he should have gone on to find that this was an improper purpose and that it did not matter

[13] Per Lord Wilberforce in Howard Smith at page 838.

that the directors were motivated by concerns about the well-being of the Fund and its equity shareholder. This finding is sufficient to allow the appeal and I will now consider the orders that this Court should make.

Relief

[46] A striking feature of this appeal and the case in the court below is that the relief claimed by the appellant includes orders setting aside the issue of the 500 class A voting shares to CTS Nominees Ltd and the transfer of those shares to Sunimar Private Ltd. Having dismissed the claim, the trial judge did not have to deal with this issue. However, he observed that the current shareholder Sunimar was not joined as the party in the court below and accordingly he could not have made an order setting aside the issue of the shares. The appellant did not appeal against this finding by the trial judge. In his submissions to this Court, Mr. Crow invited the Court to allow the appeal and remit the matter to the High Court for arguments as to the relief that should be granted. The High Court could then decide if Sunimar Private Ltd should be joined as a party.

[47] Mr. Parker countered by submitting that as there was no appeal against the judge's finding on this point, the appeal must fail in limine. Alternatively, and in any event, the relief of rectification of the share register (which is the ultimate relief being sought) could not be granted because it involves taking away the property rights of a party who was not before the court. In support of his submissions Mr. Parker relied on the case of Greenwich Millennium Exhibition Ltd v New Millennium Experience Company Ltd,[14] a case dealing with rectification of a share register.

[48] I agree with Mr. Parker's submission. In order to grant orders setting aside the issuance of the shares and rectification of the share register the current shareholder, Sunimar Private Ltd, must be heard, and, like the trial judge, I would not grant any such relief until Sunimar is heard. However, that does not preclude

[14] [2004] 1 All ER 687 at paragraph 85.

this Court from making a declaration based on the finding that the shares were issued for an improper purpose. In the circumstances, I would allow the appeal and declare that the issue of the 500 A class voting shares to CTS Nominees Ltd on 10th July 2014 was done for an improper purpose and in breach of section 121 of the British Virgin Islands Business Companies Act.

Order

[49] I would make the following orders:

(i) The appeal is allowed and the order of the learned trial judge in the court below is set aside.

(ii) It is declared that the issue of the 500 A class voting shares to CTS Nominees Ltd on 10th July 2014 was done for an improper purpose and in breach of section 121 of the British Virgin Islands Business Companies Act.

(iii) Costs of the appeal and in the court below to the appellant to be assessed if not agreed within 21 days of the date of this order.

I concur
Janice M. Pereira
Chief Justice

I concur
Mario F. Michel
Justice of Appeal

By the Court

Chief Registrar