[2016] JMSC Civ 17

IN THE SUPREME COURT OF JUDICATURE OF JAMAICA

CIVIL DIVISION

CLAIM NO. 2015HCV05096

BETWEEN	**JONI KAMILLE YOUNG TORRES (AS ADMINISTRATOR OF THE ESTATE OF KARL AUGUSTUS YOUNG)**	**CLAIMANT**
AND	**ERVIN MOO YOUNG**	**FIRST DEFENDANT**
AND	**DEBBIAN DEWAR (AS AN EXECUTOR OF THE ESTATE OF CHAD ADRIAN YOUNG AKA CHAD YOUNG)**	**SECOND DEFENDANT**
AND	**ZIP (103) LIMITED**	**THIRD DEFENDANT**

AND

BETWEEN	**ZIP (103) LIMITED**	**ANCILLARY CLAIMANT**
AND	**DEBBIAN DEWAR (AS AN EXECUTOR OF THE ESTATE OF CHAD ADRIAN YOUNG AKA CHAD YOUNG**	**FIRST ANCILLARY DEFENDANT**
AND	**DEBBIAN DEWAR**	**SECOND ANCILLARY DEFENDANT**

IN OPEN COURT

Sandra Minott Phillips QC and Simone Bowie Jones instructed by Dorothy Pine McLarty of Myers, Fletcher and Gordon for the claimant

Symone Mayhew and Kimberly Morris for the first defendant

Allan Wood QC, Tana'ania Small Davis and Miguel Williams instructed by Livingston Alexander and Levy for the second defendant

M Georgia Gibson Henlin QC and Stephanie Williams instructed by Henlin Gibson Henlin for the third defendant and ancillary claimant

January 22, 2016 and February 5, 2016

COMPANY LAW – ALLOTMENT OF SHARES – WHETHER ALLOTMENT IN ACCORDANCE WITH THE ARTICLES OF ASSOCIATION – WHETHER ALLOTMENT VALID – WHETHER ALLOTMENT SHOULD BE SET ASIDE – WHETHER REGISTER SHOULD BE RECTIFIED

SYKES J

The litigants

[1] There are many Youngs and Moo Youngs. The court will use the first names for ease of reference. No disrespect is intended. Mr Ervin Moo Young ('Ervin') and Mr Karl Young ('Karl') were brothers. Mr Chad Young ('Chad') was Karl's son and therefore Ervin's nephew. Mrs Joni Kamille Young Torres ('Joni') is another of Karl's children. Therefore she is Ervin's niece and was Chad's sister. Mrs Dewar is not related by marriage or otherwise to anyone in this case.

[2] Karl died on June 10, 2010. He did not leave a will. Chad died on February 27, 2014. He left a will. Ervin and Mrs Dewar are the named executors. Mrs Dewar had the will probated. By the terms of the will, Chad left 50% of the 490,000

shares issued to him for Mrs Dewar. The allotment and issuing of share are being challenged or, at least questioned by Joni. The challenge is not opposed by any of the defendants except Mrs Dewar. Thus despite the title of the claim, the only defendant resisting the claim is Mrs Dewar.

History of the allotment and issuing of shares

[3] Zip (103) Ltd ('Zip') was incorporated on September 20, 2001. According to the memorandum of association, Zip had an authorised share capital of 500,000.00 shares each with a nominal value of $1.00. In September 2001 two of the 500,000 shares were issued: one to Karl and the other to Mr Brian Schmidt. These two gentlemen were subscribers to the memorandum of association. Mr Schmidt transferred his one share to Mr Ervin Moo Young ('Ervin').

[4] Ervin and Karl were the very first directors. This remained so until Chad was appointed a director on August 23, 2004. Mrs Dewar was appointed a director on December 16, 2010. Mrs Dewar was appointed a director after the allotment under challenge was made. There is a challenge to whether Mrs Dewar was properly appointed but until that is determined the court will proceed on the basis that she was lawfully and properly appointed.

[5] According to the annual returns between 2001 and 2009 only two shares were allotted. On July 9, 2010 Chad was allotted 490,000. This was approximately one month after Karl's death. The minutes before the court show that a board meeting held on July 8, 2010 at which Ervin and Chad are recorded as attending. At this meeting a decision was made to allot and issue the shares to Chad. Ervin is now saying that he was not party to any discussion about the allotment of shares. The annual return for 2010 confirms the issuing of the shares to Chad.

[6] The minutes state that the directors had discussions and agreed on the allotment and issuing of 490,000 shares to Chad. Ervin's response is suggesting that the minutes are grossly inaccurate in that he had no discussions with Chad and did not agree to any allotment. He even goes as far as saying that he did not agree

that $490,000.00 should have been paid by Chad for the shares. Now that Chad is dead there is no one to say otherwise. The board minutes and the record of allotment are the only record exhibited relating to this transaction. However, it does not follow that there is any inevitability about the acceptance of Ervin's evidence on this point. It still has to be assessed in light of the other evidence in the case. The internal logic and coherence of Ervin's account has to be examined. It may be that the evidence proves unacceptable after analysis. There is no principle of law that requires uncontradicted evidence to be accepted.

[7] Ervin states in his affidavit that although he signed the return of allotment he did not know what it was that he was signing. According to him the document was simply presented to him and he signed without appreciating what it was that he was signing. He added that it was only after Chad's death and he spoke to lawyers at Nunes Scholefied DeLeon & Co that he realised what he had signed and the implications of the document. Ervin is also saying that it is only within recent times that he appreciated that the shares should have been sold at market value.

Was there a breach of the articles?

[8] Mrs Minott Phillips' first point is that the allotment and issuing of shares were decided by the two directors, Ervin and Chad, without reference to, or notification to the Estate of Karl. The submission was to the effect that the articles of association required all unissued shares be offered first to existing members before being issued. If the company did not wish to do this then it had to pass a special resolution to that effect. It is common ground that no such resolution was passed. The proposition is that the issuing of the shares was in breach of the articles of association and should be set aside. Mrs Gibson Henlin QC on behalf of Zip adopted that submission as did Mrs Symone Mayhew for Ervin.

[9] Before turning to the articles in question it is important to bear in mind that articles of association are a special kind of contract. They are the rules concerning internal management of the company; the constitution of the

company. As the law has developed and subject to the provisions of the Companies Act it is not accurate to suggest (as the submissions of Mrs Minott Phillips, Mrs Gibson Henlin and Mrs Mayhew hinted at) that once there is a breach of the articles relating to the allotment of and issuing of shares it necessarily and inevitably follows that the remedy must necessarily be a setting aside of the allotment and issuing of shares.

[10] Reference was made to the decision of Edwards J in **Northover v Northover** [2014] JMCC Comm 14. Her Ladyship did not accept the proposition that breach of pre-emption rights provisions when previously unissued shares are being issued, ipso facto, meant that the allotment and issuing of shares were automatically invalid. What Edwards J found in that case was that there was a breach of the procedure laid down in the articles and therefore the allotment and issuing of the shares were invalid. Her Ladyship also found that the purpose of allotment was to shift the balance of power within the company.

[11] In addition, when it comes to the directors of a company exercising the power to issue shares the courts have engrafted the equitable principle that the power must only be exercised for a proper purpose. The duty flows out of the fact that directors are in a fiduciary relationship with the company.

[12] The primary relevant article is number 47 which reads:

> *(a) Unless the company shall by special resolution otherwise direct all unissued shares (whether in the original or any increased share capital) shall, before such issue, be offered to the member. …*
>
> *(b) …*
>
> *(c) …*
>
> *(d) For the purpose of this article, where any person is unconditionally entitled to be registered as the holder of a share, he and not the person actually registered as the holder thereof,*

shall be deemed to be a member of the Company in relation to that share.

[13] Mr Allan Wood QC took the view that articles 34, 35 and 133 are also relevant. The other attorneys did not agree. These articles deal with deceased persons who held shares. These articles are now set out:

Article 34

In case of death of a member the survivor or survivors where the deceased was a joint holder, and the ***legal personal representatives*** *of the deceased where he was a sole holder, shall be the only persons recognised by the Company as having any title to his interest in the shares, but nothing herein contained shall release the estate of a deceased joint holder from any liability in respect of any share which had been jointly held by him with another person.* (emphasis added)

Article 35

Any person becoming entitled to a share in consequence of the death … of a member may, upon such evidence being produced as may from time to time properly be required by the directors and subject as hereinafter provided, elect either to be registered himself as the holder of the share or to have some person nominated by him registered as the transferee thereof, but the directors shall in either case, have the same right to decline or suspend registration as they would have had in the case of a transfer of the share by that member before his death or bankruptcy as the case may be.

Article 133

A notice may be given by the Company to the persons entitled to a share in consequence of the death … of a member by sending it through the post in a prepaid letter …

[14] When it comes to the interpretation of commercial documents generally and articles of association in particular the rule is that 'the plain and ordinary meaning of the words used … can only be displaced if it produces a commercial absurdity'

(**John Thompson, Janet Thompson v Goblin Hill Hotels Ltd** [2011] BCLC 587; [2011] UKPC 8 **[18]** Lord Dyson).

[15] The court agrees with Mr Wood that articles 34, 35 and 133 are relevant to determining whether any of the beneficiaries of Karl's estate should have been made an offer. Article 34 is plain. It tells the company who it should deal with in cases where the shareholder has died. The article states what where the share was held jointly, then the company is permitted to recognise the surviving joint holder as the person having title to the share. On the other hand if the shareholder held the share singly, the company can only recognise the legal personal representatives as the person having title to the share.

[16] The expression 'personal representatives' in the article is qualified by the adjective 'legal.' The article does not refer to beneficiaries but legal personal representatives. Prima facie therefore there is no foundation for the proposition that the company was under a legal obligation to contact or recognise the beneficiaries.

[17] Where a person dies intestate the law already tells us how that matter is to be resolved. As Mr Wood pointed out someone has to take the steps necessary to obtain letters of administration. The company cannot determine who that person should be. Until someone is legally constituted as the personal representative of the deceased shareholder that someone or indeed any other person cannot be recognised as having any title to the share for the purposes of the articles. No such person was the legal personal representative of Karl for over five years. Joni only became the administratrix of Karl's estate on August 28, 2015 and consequently the legal personal representative of Karl's estate. She gets her authority from the letters of administration. Before the letters of administration were granted to her she was not the legal personal representative of the estate. Joni, therefore, was not unconditionally entitled to be registered as the holder of Karl's share until she was granted the letters of administration.

[18] As this court understands it the general position is that it is the person handling the deceased's estate who is to inform the company of the death of the person. In this case, Ervin and Chad as the brother and son of Karl respectively would have known of his death and in that sense the company would have known of his death but beyond that knowledge there was nothing the company could do until someone was lawfully appointed to administer the estate.

[19] Mr Wood also made another point with which this court agrees. The fact that someone becomes the holder of a share by operation of law without more does not make that someone a member of the company. Despite this, it is true to say that the courts have been generous in their interpretation of the expression member (where the articles or statute do not suggest otherwise) and have extended it to include the personal representative of the deceased member. In this case the matter is resolved by section 23 (1) of the Companies Act where it says that members of a company include 'the personal representative of a deceased member.' Until such a person is appointed there is no person who can be a member by virtue of holding the deceased person's share.

[20] The question is whether this conclusion is absurd. Mrs Minott Phillips suggested that when one looks at the short lapse of time between Karl's death and the issuing of the shares, in practical terms there was simply not sufficient time for anyone to become the personal representative for the purposes of the articles. There was indecent haste. Mr Wood countered by saying that even if that were so nothing happened for over five years and in that time the company's business had to go on.

[21] It would seem to this court that Mr Wood is correct. The fact that the articles did not make provision for any time lapse between the death of a shareholder and the issuing of shares was perhaps, in hindsight, not such a good idea. It may be that author of the articles thought of it and decided not to address it or perhaps he did not think of it at all. Regardless of the reason for the omission, the court cannot fix this problem by implying some term regarding time between death of

shareholder and when unissued share can be offered. In any event no submissions were made regarding implying any term to that effect and so the court need not consider that possibility any further.

[22] This court abides the advice of Lord Hoffman in **Attorney General of Belize v Belize Telecom Ltd** (2009) 74 WIR 203 at paragraph 16: '*The court has no power to improve upon the instrument which it is called upon to construe, whether it be a contract, a statute or articles of association. It cannot introduce terms to make it fairer or more reasonable*.'

[23] Mrs Minott Phillips submitted that article 47 (a) gives a right of pre-emption to the shareholders with respect to unissued shares and that this right is supported by section 61 of the Companies Act which states that '[i]f the articles so provide, no shares or class of shares may be issued unless the shares have first been offered to the shareholders of the company holding shares of that class.'

[24] The court agrees that article 47 (a) accords pre-emption rights to the existing members. For this provision to work in the case of a deceased who dies intestate then someone must move quickly to be as the legal personal representative. Until that is done there is simply no one in existence to whom the article can apply. The company cannot make an offer to a non-existent person. Until Joni was appointed there was no person to whom article 47 could apply and thus there was no breach of the article in this regard. If no one steps forward to take up the administration of the estate the company cannot sit idly by. It is a going concern and decisions have to be made.

[25] Mrs Gibson Henlin QC contended that even if there was no personal representative that is not the end of the matter. The company should have passed a special resolution in accordance with the article to dispense with the requirement to offer the shares to existing member. None was passed and therefore the breach of the article has been established. It is the view of this court that this special resolution only arise if the decision is taken to issue the unissued shares and there are in fact members to whom the offer can be made. If there

are no such members then there is no need for any special resolution (article 47 (c)). The special resolution is an alternative to offering the shares to existing members.

[26] Mrs Symone Mayhew submitted that there was no evidence that Ervin, an existing member, was made an offer in keeping with article 47. Ervin's position demands careful examination. It was Ervin who signed the return of allotment. He was present at the meeting of July 8, 2010. Ervin does not strike the court as a man lacking in intelligence. He may not be lawyer but he has common sense. He must, as a director for nearly ten years at the time of the allotment and issue of share, have known of the articles of association. He must be taken to be aware that it has something to say about the issuing of shares. At very least he must have appreciated that since he had only one share agreeing to the allotment and issuing of the 490,000 would have made him a minority shareholder. Clearly, he had no difficulty with being a minority shareholder. He was not concerned about being made a minority shareholder. In fact, none of his affidavits has remotely suggested that he wanted to maintain his 50% portion in the issued shares. Obviously, he thought that it was in the best interest of the company for the share to be issued to Chad. So comfortable was he that between 2010 and Chad's death in February 2014 he expressed no anxiety or concern about his minority position. It was not until Chad's death that the issuing of shares to Chad became an issue. It is this court's view that a party to a contract is always free to decline to accept the protection offered to him by a provision of the contract. This is exactly what has happened in this case. Ervin declined to take the protection offered. He is free to do so. Freedom to contract must include the freedom to refuse contractual protection.

[27] Ervin has not asserted that he was tricked or misled or deceived by Chad. His eyes were wide open. The court also noted that the date of the signature on the return of allotment is September 9, 2010. In other words it was two months between the date of the decision and the date of signing the document to be sent to the Registrar of Companies. He had at least two months to reflect on the

decision he had made. Had he any doubts he had more than ample opportunity to consult a lawyer. He had become a very minority shareholder but based on his conduct he had no difficulties with that. After he signed in September 2010 he continued in a state of blissful happiness until Chad died. The court proceeds on the basis that he was aware that the articles dealt with the allotment and issuing of shares. With that knowledge he decided and indicated by his unequivocal acts of being an active participant in the decision to allot and issue the shares that he was waiving the protection offered by article 47.

[28] For all these reasons this court concludes that did not wish to have the benefit of article 47. He has the absolute right to decline the benefit of any protective clause that was in his favour. Having decided that the shares were lawfully issued the next step in the analysis is to determine whether the allotment and issue can be set aside on the ground that they were issued for an improper purpose.

Whether decision to allot and issue share made for a proper purpose

[29] If there is no breach of the article the matter does not rest there because of what was said earlier regarding the directors' fiduciary duty to the company. The proposition advance is that Ervin and Chad as directors owed a fiduciary duty to the company to exercise their power to allot and issue the shares for a proper purpose – the proper purpose rule. What is this rule? What is its origin? What is its function and purpose?

[30] The proper purpose rule, in this context, is that the person with the power (called the donee of the power in older cases on powers and trustees decided by the Courts of Equity) must exercise the power only for the purpose for which it was given. It is important to note in this regard that it the exercise of the power, if not used for the purpose for which it was given, is not saved from invalidity because the donee or holder of the power acted in the best interest, as he understood, of the person for whom or on whose behalf he exercised the power. This rule is applied to directors of companies because they are in a fiduciary relationship with

the company. It is equity's way of policing the exercise of the power. Having said this it should be noted that the rule is not applied with same undiluted intensity to directors as it is applied to trustees but it is applied nonetheless. This point was made by Dixon J in **Mills v Mills** 60 CLR 150, 185 – 186. This was not disapproved by Lord Wilberforce in **Howard Smith v Ampol Petroleum** [1974] AC 821. In fact it seemed to have been cited with full approval.

[31] This is its origin according to Lord Sumption in **Eclairs Group Ltd v JKX Oil & Gas plc** [2015] UKSC 71 at paragraph 15:

> *The proper purpose rule has its origin in the equitable doctrine which is known, rather inappropriately, as the doctrine of "fraud on a power". For a number of purposes, the early Court of Chancery attached the consequences of fraud to acts which were honest and unexceptionable at common law but unconscionable according to equitable principles. In particular, it set aside dispositions under powers conferred by trust deeds if, although within the language conferring the power, they were outside the purpose for which it was conferred.*

[32] Even though the expression 'fraud on a power' is used, it is important to note that it has nothing to do with dishonesty, immorality and the like. It simply means that the power was exercised for a purpose or an intention that, though within the actual words of the instrument creating the power, was outside the purpose for which the power was created.

[33] The proper purpose rule in respect of company directors usually arises in a particular context. Lord Sumption accurately captured it at paragraph 15 where his Lordship said:

> *The important point for present purposes is that the proper purpose rule is not concerned with excess of power by doing an act which is beyond the scope of the instrument creating it as a matter of construction or implication. It is concerned with abuse of power, by doing acts which are within its scope but done for an improper reason. It follows that the test is necessarily subjective. "Where the question is one of abuse of powers," said Viscount Finlay in Hindle*

v John Cotton Ltd (1919) 56 Sc LR 625, 630, "the state of mind of those who acted, and the motive on which they acted, are all important".

[34] Lord Wilberforce explained the same thing in **Howard Smith** at page 834:

But, intra vires though the issue may have been, the directors' power under this article is a fiduciary power: and it remains the case that an exercise of such a power though formally valid, may be attacked on the ground that it was not exercised for the purpose for which it was granted.

[35] The main case relied on by the claimant, and defendants who support the claim or if not in support did not oppose it, is **Howard Smith**. In that case the primary judge had set aside the issue of shares in RM Miller Holdings Ltd ('RMM') to Mr Howard Smith. There was a bitter struggle for the control of RMM between Ampol on the one hand and Howard Smith on the other. On the side of Ampol was a company known as Bulkships Ltd ('Bulk'). Ampol and Bulk, who was a shareholder in Ampol, together held 55% of the shares in RMM. Smith's allotment and issue of share had the effect of reducing Ampol and Bulk from majority to minority shareholders in RMM.

[36] The background to this was that Smith and others who supported him wanted to prevent the control of RMM passing to Ampol. Smith announced that he would make a take-over bid by offering to purchase shares at a stated price. Ampol and Bulk responded by stating that they intended to act together in future operations. Obviously, their 55% share in RMM constitute them a majority and therefore could dominate the decision process of the company. To forestall this, Smith and others hatched a plan whereby shares would be issued to Smith. The evidence showed that the primary purpose of this stratagem was to turn Ampol and Bulk into minority shareholders. The plan was executed and this was how the additional shares came to be issued to Smith. This led to the challenge to the issue of the shares. There was evidence that RMM was in need of additional capital at the time.

[37] The task of the trial judge was to decide whether the primary purpose of the directors of RMM was to meet RMM's proven need for additional capital or whether the primary purpose was to destroy Ampol's and Bulk's majority shareholding thereby handing control over to Smith. The trial judge, despite protestations to the contrary, found that the primary purpose of issue of shares was to destroy Ampol's and Bulk's majority shareholding despite the fact that RMM, on an objective view, was in need of further capital injection. The judge found that need for capital while pressing was not that urgent because the situation had existed for some time and the company though struggling was not in such a state that the absence of new capital would have sent the company to its grave. These findings were upheld by the Privy Council. It was accepted that the power to issue the share was within the power of the directors. In other words the act of issuing share was intra vires and the question was whether the power was exercised for a proper purpose.

[38] It is important to follow closely the reasoning of Lord Wilberforce. Mrs Gibson Henlin came dangerously close to suggesting that unless the issuing of the shares was for the purpose of raising capital then any issuing of shares must necessarily be viewed in a jaundiced way. The unstated corollary is that the court should not hesitate to set aside the allotment and issuing of shares because the purpose could not possibly be a proper one.

[39] The court understands why Mrs Gibson Henlin made this submission. Mrs Gibson Henlin like Mrs Minott Phillip have an acute problem and this is the paucity of evidence from their clients on this issue. For Mrs Gibson Henlin who represents Zip no one has been able to provide much evidence surrounding the issuing of the shares. All counsel has are the minutes, the return of allotment and an inconclusive affidavit from Ervin. For Mrs Minott Phillips her client could not help much. In Joni's own words: she 'was resident overseas and completely uninvolved with the business affairs of [my father and Chad]' and had 'nothing more than rudimentary knowledge of the existence of Irie-FM and Zip (103) FM'

(paragraph 13 of affidavit dated January 4, 2016). Mrs Dewar was not a director of Zip when the decision was made.

[40] In this case the minutes of the directors' meeting placed before the court and the other documentation do not reveal much by way of indicating what the thinking of the directors were. Indeed, the only director alive who can speak to those matters is Ervin who was not cross examined. His affidavits did not tell much about the reasons for the issuing of the shares. What he sought to do was to suggest no discussion of any kind took place regarding the allotment and issuing of the shares. For reasons given above and to be given below the court does not accept Ervin's evidence on this point.

[41] Given the parlous state of the evidence it was not surprising that Mr Wood submitted that in **Howard Smith** and the other cases in which the directors' exercise of the power allot and issue shares was successfully challenged were all cases where there was some evidence of what the directors' thought processes were and that there was evidence from which the court could conclude that the directors had exercised their power for an improper purpose. He submitted that it would be wrong in principle, having regard to the burden of proof, to infer that the directors' must have had an improper purpose in mind simply because the claimant has no affirmative evidence to show what the purpose was.

[42] To return to Lord Wilberforce's reasoning. When his Lordship stated that '*intra vires though the issue may have been, the directors' power under this article is a fiduciary power: and it remains the case that an exercise of such a power though formally valid, may be attacked on the ground that it was not exercised for the purpose for which it was granted*' (page 834) it was in the context of rejecting the extremes of both arguments that were advance before the Board. The first was that once the power was exercise bona fide and that the directors were not motivated by self-interest, then that is the end of the matter. The second was that '*that the purpose for which the power is conferred is to enable capital to be raised*

for the company, and that once it is found that the issue was not made for that purpose, invalidity follows' (page 834). The reasons for the rejection of the second argument by Lord Wilberforce are important because they say why this court cannot accept Mrs Gibson Henlin's submission that unless it can be said that reason for the exercise of the power in this case was for the purpose of raising capital then it necessarily follows that the purpose was improper.

[43] At page 835 Lord Wilberforce said:

> *On the other hand, taking the respondents' contention, it is, in their Lordships' opinion, too narrow an approach to say that the only valid purpose for which shares may be issued is to raise capital for the company. The discretion is not in terms limited in this way: the law should not impose such a limitation on directors' powers. To define in advance exact limits beyond which directors must not pass is, in their Lordships' view, impossible. This clearly cannot be done by enumeration, since the variety of situations facing directors of different types of company in different situations cannot be anticipated.*

[44] The proper analytical approach was stated thus at page 835:

> *In their Lordships' opinion it is necessary to start with a consideration of the power whose exercise is in question, in this case a power to issue shares. Having ascertained, on a fair view, the nature of this power, and having defined as can best be done in the light of modern conditions the, or some, limits within which it may be exercised, it is then necessary for the court, if a particular exercise of it is challenged,* ***to examine the substantial purpose for which it was exercised****, and to reach a conclusion whether that purpose was proper or not. in doing so it will necessarily give credit to the bona fide opinion of the directors, if such is found to exist, and will respect their judgment as to matters of management; having done this, the ultimate conclusion has to be as to the side of a fairly broad line on which the case falls.* (emphasis added)

[45] Before going on it is important to note the expression 'substantial purpose for which it was exercised.' Implicit in this, as shall be shown below, is the idea of causation. Why did the directors do what they did? In other words what was the

crucial factor that led to the decision? It is the identification of this factor that determines whether the exercise of the power was for a proper purpose. This must be identified from evidence presented not intelligent speculation.

[46] At page 836 Lord Wilberforce approved the reasoning of High Court of Australia to the effect that the issuing of shares to secure the financial stability of the company is a legitimate purpose for issuing shares even though the effect of the issue was to defeat the claimant's efforts to control the company (**Harlowe's Nominees Pty Ltd v Woodside (Lake Entrance) Oil Co** (1968) 121 CLR 483). His Lordship accepted Byrne J's view that there can be good reasons other than raising capital for shares to be issued (**Punt v Symons & Co Ltd** [1903] 2 Ch 506). This means that while it may be important to determine whether capital was needed at the time of the share issue '*but that ultimate question must always be whether in truth the issue was made honestly in the interests of the company*' and this court would add, for a proper purpose (**Harlowe's Nominees** at p 493, quoted by Lord Wilberforce at page 836).

[47] On the facts of **Howard Smith** (in sharp contrast to **Harlowe's**) Lord Wilberforce observed at pages 837 – 838:

> *The purpose found by the judge is simply and solely to dilute the majority voting power held by Ampol and Bulkships so as to enable a then minority of shareholders to sell their shares more advantageously. 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. 10; Punt v. Symons & Co. Ltd. [1903] 2 Ch. 506; Piercy v. S. Mills & Co. Ltd. [1920] 1 Ch. 177 ('merely for the purpose of defeating the wishes of the existing majority of shareholders') and Hogg v. Cramphorn Ltd. [1967] Ch. 254. In the leading Australian case of Mills v. Mills, 60 C.L.R. 150, it was accepted in the High Court that if the purpose of issuing shares was solely to alter the voting power the issue would be invalid. And, though the reported decisions, naturally enough, are expressed in terms of their own facts, there are clear considerations of principle which support the trend they establish. The constitution of a limited company normally provides for directors, with powers of*

> *management, and shareholders, with defined voting powers having power to appoint the directors, and to take, in general meeting, by majority vote, decisions on matters not reserved for management. 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. If there is added, moreover, to this immediate purpose, an ulterior purpose to enable an offer for shares to proceed which the existing majority was in a position to block, the departure from the legitimate use of the fiduciary power becomes not less, but all the greater. The right to dispose of shares at a given price is essentially an individual right to be exercised on individual decision and on which a majority, in the absence of oppression or similar impropriety, is entitled to prevail. 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 the share capital 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.*

[48] So that is the context of Lord Wilberforce's judgment. Again, the underlying theme of causation is evidence. Having outlined the task of the trial judge in the case before the board, Lord Wilberforce recognised that the trial judge had to find a causal connection between the issuing of the shares and the purpose of the directors. If there is no proven causal connection between the issuing of the

shares and the alleged improper purpose then the allegation of issuing the shares for an improper purpose must necessarily fail.

[49] This leads to the recently decided case of **Eclairs Group Ltd v JKX Oil & Gas plc**. In that case, Lord Sumption gave an exposition of the issue of causation. The authority of his Lordship's pronouncements is weakened by the observation of the other Justices of the Supreme Court that it was not necessary to give a concluded position on the point since it was not fully argued. Notwithstanding this infirmity this court is of the view that Lord Sumption's observations are helpful. Lord Sumption's reasoning is compelling once we understand what causation is. A cause, in this company law context, is that which decisively influences the decision that was made whether it was a dominant purpose or one of multiple purposes. When viewed in this way this explains why it has been said that principle although originating in the law relating to trustees is not applied with all the rigour associated with it when applied to trustees. This court also notes that the very passages from **Mills v Mills** relied on by Lord Sumption were the very passages cited without disapproval by Lord Wilberforce in **Howard Smith**. Lord Sumption was not breaking new ground. His Lordship was simply drawing for our benefit the complete picture arising from the outline of Dixon J in **Mills v Mills**.

[50] However, as Lord Sumption pointed out, directors of a company may be motivated by a myriad of factors and it would be foolish to think or require directors to take a Pollyanish view (this court's words and not Lord Sumption's) of the world and pretend that they are totally ignorant of some of the consequences of their decisions. Thus if the proper purpose rule is to be applied sensibly then the question of causation has to be addressed. If there are multiple purposes (proper and improper) for making a decision, the court, according to Lord Sumption, has to decide which purpose was dominant or the one that caused the decision to be made. These two ways of stating the matter do not necessarily always yield the same result. It may be possible to identify the dominant purpose by identifying the one which the directors felt most strongly about. In respect of the second way of stating the matter (namely, the factor that caused the decision

to be made where there are many competing factors) this court understands Lord Sumption to be saying that there may be competing purposes but none emerges as the one the directors feel most strongly but yet there is a purpose/factor that ultimately tips the balance of the decision. The purpose that tips the balances is the causative one regardless of how small it may and if that purpose is wrong then the decision can be impugned.

[51] In **Howard Smith** two (and only two) possible competing purposes emerged from the evidence. The first was to increase the share capital and the second was to prevent the take-over of the company by Ampol and Bulk by transforming them into minority shareholders. The learned trial judge was able to eliminate the first possible purpose by finding that despite the urgent need for capital, the company had managed its difficulties by a means other than issuing capital. The underlying question that the trial judge had to answer was why did it only occur to the director to issue new shares in the context of a possible hostile take-over of the management of the company when the need for raising capital had always existed and the company had managed that need by other means? What was it that caused the use of the issuing of shares at this point to be the solution when that had not been done before? Why use the method of issuing shares which would turn the majority shareholders into minority ones? In that context it is not hard to see why the trial judge found an improper purpose despite the fact that the issuing of the shares was within the power of the directors. The conclusion of the trial judge was inevitable once it is understood that what the trial judge had before him was company with chronic and long standing need for capital. This time round the same need arose but the solution was different. What additional factor was present in these circumstances that was absent from the others? The answer was the risk of the company being dominated by two existing shareholders who together controlled 55% of the issued shares. The only way to forestall this was to turn them into minority shareholders which meant that their vote would never change or adversely affect the decision of the now new majority shareholder.

[52] The trial judge in **Howard Smith** expressly relied on the following passage from Dixon J in **Mills v Mills** 160 CLR 150, 185:

> *Directors of a company are fiduciary agents, and a power conferred upon them cannot be exercised in order to obtain some private advantage or for any purpose foreign to the power. It is only one application of the general doctrine expressed by Lord Northington in Aleyn v. Belchier: "No point is better established than that, a person having a power, must execute it bona fide for the end designed, otherwise it is corrupt and void."*
>
> *Upon the facts of the present case, or at all events upon the expressions used by Lowe J. in stating his findings, it may be thought that a question arises whether there must be an entire exclusion of all reasons, motives or aims on the part of the directors, and all of them, which are not relevant to the purpose of a particular power. When the law makes the object, view or purpose of a man, or of a body of men, the test of the validity of their acts, it necessarily opens up the possibility of an almost infinite analysis of the fears and desires, proximate and remote, which, in truth, form the compound motives usually animating human conduct. But logically possible as such an analysis may seem, it would be impracticable to adopt it as a means of determining the validity of the resolutions arrived at by a body of directors, resolutions which otherwise are ostensibly within their powers. The application of the general equitable principle to the acts of directors managing the affairs of a company cannot be as nice as it is in the case of a trustee exercising a special power of appointment. It must, as it seems to me, take the substantial object the accomplishment of which formed the real ground of the board's action. If this is within the scope of the power, then the power has been validly exercised. But if, except for some ulterior and illegitimate object, the power would not have been exercised, that which has been attempted as an ostensible exercise of the power will be void, notwithstanding that the directors may incidentally bring about a result which is within the purpose of the power and which they consider desirable.*

[53] Lord Wilberforce expressly approved the test of Dixon J which was used by the trial judge and upheld the trial judge's findings of fact based on the application of

the test (see page 831 – 833). This passage was approved by Lord Sumption and this court adopts it because it makes infinite sense.

[54] In the passage just cited Dixon J was seeking to apply the proper purpose test in a sensible manner. His Honour emphasised that when examining the decision of a board of directors one ought to look for the substantial purpose they sought to achieve and if that purpose is within the board's power then the power was validly exercised. If the main purpose of the exercise of the power was illegitimate then the power is not validly exercised even if the result was an outcome within the actual wording of the power. This court respectfully adopts the analysis of Lord Sumption of the last sentence of Dixon J's dictum which was that where there are competing purposes and there is one that tips the scale in favour of exercising the power and that purpose was illegitimate and but for that illegitimate purpose the power would not have been exercised then the exercise of the power is vulnerable to challenge.

[55] To close then, this court agrees with this passage from Lord Sumption at paragraphs 21 – 22:

> *One has to focus on the improper purpose and ask whether the decision would have been made if the directors had not been moved by it. If the answer is that without the improper purpose(s) the decision impugned would never have been made, then it would be irrational to allow it to stand simply because the directors had other, proper considerations in mind as well, to which perhaps they attached greater importance. This was the point made by Dixon J in the passage immediately following the one which I have cited from his judgment in Mills v Mills*
>
> *"But if, except for some ulterior and illegitimate object, the power would not have been exercised, that which has been attempted as an ostensible exercise of the power will be void, notwithstanding that the directors may incidentally bring about a result which is within the purpose of the power and which they consider desirable."*
>
> *Correspondingly, if there were proper reasons for exercising the power and it would still have been exercised for those reasons*

even in the absence of improper ones, it is difficult to see why justice should require the decision to be set aside.

22 Dixon J's formulation has proved influential in the courts of Australia. As the majority (Mason, Deane and Dawson JJ) pointed out in the High Court of Australia in Whitehouse v Carlton House Pty (1987) 162 CLR 285, 294:

"As a matter of logic and principle, the preferable view would seem to be that, regardless of whether the impermissible purpose was the dominant one or but one of a number of significantly contributing causes, the allotment will be invalidated if the impermissible purpose was causative in the sense that, but for its presence, 'the power would not have been exercised'."

I thing that this is right. It is consistent with the rationale of the proper purpose rule.

[56] In all this discussion of the cases the undeniable golden thread is that there must be evidence of improper purpose. She who alleges must prove. There must be evidence from the challenger that the power was exercised for an improper purpose. At the commencement of the challenge the evidential burden is on the challenger and the legal burden remains on the challenger throughout. The challenger must adduce sufficient evidence which, if left unchallenged, may lead to the conclusion that the improper purpose is established. From the cases examined none has shown that the only thing the needs be done is to say the shares were issued, I don't know why they were issue and I don't know much about the affairs of the company and thereafter the evidential burden shifts to the directors. This is, to be exceptionally generous, at best suspicion about the purpose but is not capable of proving that allotment and issue were for an improper purpose. The evidence can be direct or circumstantial but evidence there must be. It is not for the directors to prove that the purpose was proper but for those attacking the decision to prove that purpose was illegitimate.

[57] What complicates matters is that the test is entirely subjective. The enquiry is always about the purpose for which the directors exercised the power. The court is not looking at how reasonable directors in the same position as those directors

whose decision is under attack would have acted but rather the court is looking for the subjective reasons why these particular directors made the decision that they did.

[58] Once, as the authorities point out, there is no such principle which states that shares can only be issued for the raising of capital then we are squarely within the realm of multiple reasons for the directors exercising the power to issue shares. What has happened here is that Joni is faced with multiple possible explanations for the issuing of the shares. She has no evidence that can point to an illegitimate purpose as the main purpose or the purpose that tipped the decision in favour of issuing the shares. What appears to have happened is that the most unfavourable explanation was chosen as the purpose and thereafter left it up to the directors to explain

[59] In this particular case, the submissions of counsel in support of the claim and ancillary claim focused on (a) the effect of the decision and (b) the silence of the records, to support the submission that purpose was improper. Joni has not said one word about the reasons for the decision. In fairness to her she could not because she was not involved in the company and did not know anything about its affairs. Ervin, as noted earlier, even though a director from the beginning, does not address the issue of reasons for the decision and the objective of the allotment and issuing of the shares. From what he has said he suggests that there was no reason for the allotment and issuing of the shares. He was simply presented with a document which he signed and it turned out to be the return of allotment.

[60] Mrs Minott Phillips, on behalf of Joni, submitted that the purpose of the allotment was to destroy the existing majority and creating a new one. How do we know this? What evidence direct or circumstantial points to this? The fact that a majority may be destroyed without more cannot mean that the purpose was improper. If the court understands Mrs Minott Phillips' logic it would necessarily follow that if the majority was preserved then it could be said that purpose was

proper. This reasoning would be equally objectionable. The court therefore concludes that the objection to the issuing of the shares on the basis that they were issued for an improper purpose fails.

[61] Mrs Gibson Henlin on Zip's behalf submitted that the purpose of the allotment was to give majority control to Chad. How do we know this? The fact that that was one of the consequences does not mean that that was a reason. In **Howard Smith** the challenger produced the evidence. Zip has not adduced evidence to show that dominant reason or, if there were multiple reasons, the one that finally influenced the decision was Chad's and Ervin's desire to convert Ervin and the Estate of Karl into minority shareholders, or some other improper purpose.

[62] The court takes account of the observation of Lord Greene MR in **In Re Smith and Fawcett Ltd** [1942] Ch 304 where his Lordship said at page 308 – 309:

> *Speaking for myself, I strongly dislike being asked on affidavit evidence alone to draw inferences as to the bona fides or mala fides of the actors. If it is desired to charge a deponent with having given an account of his motives and his reasons which is not the true account, then the person on whom the burden of proof lies should take the ordinary and obvious course of requiring the deponent to submit himself to cross-examination. That does not means that it is illegitimate in a proper case to draw inferences as to bona fides or mala fides in cases where there is on the face of the affidavit sufficient justification for doing so, but where the oath of the deponent is before the court, as it is here, and the only grounds on which the court is asked to disbelieve it are matters of inference, many of them of a doubtful character, I decline to give to those suggestions the weight which is desired.*

[63] This court would say the same in respect of determining whether the person acted for an improper purpose. If it is desired to say that Ervin exercised his director's power for an improper purpose then he should have been subjected to cross examination especially since he is the only director alive who was at that meeting. Ervin seems to be saying in his affidavit that he never addressed him mind to the purpose and presumably (the argument is that if he did not address

his mind to the issuing of shares) the foundation for the exercise of the power for a proper purpose is non-existent and therefore he did not exercise his power for a proper purpose unless there is contrary evidence or at least evidence that neutralises this possible inference.

[64] That is not the end of the story. It is important to examine the minutes of the July 8, 2010 board meeting more closely. The minutes record that Ervin and Chad were present. Chad is recorded as the chairman. It also says that the minutes from the previous directors' meeting were read, signed and confirmed. On the crucial issue of allotment of shares, it reads that the directors had discussions and it was agreed that 490,000 shares would be issued to Chad. The return of allotment was signed by Ervin. The date on the return of allotment is September 9, 2010. An examination of the document shows that it is headed return of allotment. At the bottom of the first page the box ticked indicated that the shares in question were newly issued shares. On the second page the particulars of shares indicated that 490,000 were to be issued. The third page indicated that the allottee was Chad. The fifth page bears Ervin's signature and the box ticked that he was a director. What could possibly be complicated about this that Ervin did not or could not understand?

[65] This court finds it difficult to accept that Ervin did not pass his eyes over the document before he signed for that is the only way he could have signed without appreciating what he was signing. The document is not long. It does not have complicated legal language. In his affidavit Ervin is not saying that Chad misled him as to the nature of the document. He is not even saying he did not know what the document was. He says he signed it 'without thinking anything of it and without taking any legal advice.' What does this mean? One meaning is that he did not think the document sufficiently complicated so as to require legal advice. If this is so, the likely reason for this is that the document was plain and simple and consistent with what was agreed by him at the July 8 meeting.

[66] Indeed in his December 8, 2015 affidavit he is not saying that he did not attend the July 8, 2010 meeting. Ervin's December 8, 2015 affidavit was filed in response to Joni's affidavit dated October 28, 2015. It is Joni's affidavit that exhibits the minutes of the July 8, 2010 meeting. If he did not attend that meeting one would have expected him to say in his December 8, 2015 affidavit that he was not at the July 8, 2010 or if present the minutes do not accurately record what happened. Ervin even filed another affidavit dated December 23, 2015. In that affidavit he does not address the minutes of July 8, 2010.

[67] He must have appreciated that 490,000 is more than one and that the effect of issue would make him a minority shareholder. The more reasonable conclusion, on the evidence, is that Ervin was at the July 8, 2010 meeting; he took part in discussions; agreed to the allotment and issuing of the shares; he recognised he would become a minority shareholder and had no difficulty with that. This is the best explanation for his statement that he signed 'without thinking anything of it and without taking any legal advice.'

[68] Thus based on the evidence it is this court's conclusion that Ervin did address his mind to the allotment and issuing of shares. Ervin has not said that he has never read the articles of association. He may not know all the details but he has not professed a complete ignorance of either their existence or contents.

[69] In the absence of clear evidence to that effect this court is not able to infer that Ervin and Chad exercised the power to issue the shares for an improper purpose. As Mr Wood pointed out why should a lack of evidence lead to an adverse inference of lack of proper purpose when the burden is on Joni to establish that the directors did not issue the shares for a proper purpose? If it were otherwise then it would mean that virtually every decision by directors to issue share would be prima facie for an improper purpose unless they prove otherwise. Nothing that this court has indicates that this is how the law approaches the matter. The court therefore declines to find that the shares were issued for an improper purpose.

Payment for shares

[70] The next argument made, and this was pressed more by Mrs Gibson Henlin than other counsel, is that the shares were not paid for at their fair market value. The 'evidence' (to give the word a wide and unnatural meaning) in support of this comes from the affidavit of Ervin dated December 16, 2015. All he says is that he was told by his attorneys that the shares must issued for a fair market value. Ervin says he is not aware of a contract or memorandum for the sale and purchase of the shares. He puts forward the opinion (for that is what it is) that the shares were purchased for less than fair market value. He goes from allegation of fact to conclusion. What is missing is the evidence in support of the conclusion.

[71] How does Ervin get to this conclusion? He does not adduce any evidence at all. Less than fair market value can only mean that there was a market value and that it was properly arrived at, hence the use of the adjective fair, and that the price paid for the shares was less than that fair market value. There is no evidence of this. Conceptually, this is no different from a mortgagee accusing the mortgagor of selling the security at an undervalue. The mortgagee must prove that the true value of the property was before one can even begin to discuss whether the actual sale price was under that value.

[72] This evidential gap has been supplied by the ingenuity of Mrs Gibson Henlin. Her submission is this: the Companies Act 2004 has abolished the concept of par or nominal value (section 36). In order to accommodate companies incorporated before the present Act came into force, section 37 (1) gives those companies six months to decide whether it will keep its existing shares are nominal or par value. If it makes the election to retain nominal or par value then it can continue issuing shares are nominal or par value. Under section 37 (2) if the company fails to make such an election then after six months it is deemed not to retain shares at nominal or par value and any shares issued is not at nominal or par value. There was no resolution in the case of Zip to retain the nominal or par value of shares

and so the deeming provision applies. This means, says Mrs Gibson Henlin, that the price paid for any of the shares must necessarily be the fair market value.

[73] Learned counsel proceeded to apply this principle to the case: in this case it is agreed that the nominal value is $1.00 per share. Zip issued 490,000 shares for which Chad paid $490,000.00. The multiplication leads to the inevitable conclusion that purchase was made at nominal value. This is contrary to the statute says Mrs Gibson Henlin. Thus without any proof of what the fair market value was Mrs Gibson Henlin arrives at the conclusion that the price paid by Chad was necessarily less than fair market value.

[74] The fact that the price paid coincides with the nominal or par value does not inevitably mean that that price was not a fair market value. Ervin's affidavit and Mrs Gibson Henlin's submissions are based on the unproven notion that the fair market value must necessarily be greater than $1.00 per share. If this were not the case then the proposition that the shares were sold at an undervalue could not be made in this case.

[75] Joni does not address the issue of the alleged issue of shares at an under value. She could not because, as noted earlier, she 'was resident overseas and completely uninvolved with the business affairs of [my father and Chad]' and had 'nothing more than rudimentary knowledge of the existence of Irie-FM and Zip (103) FM' (paragraph 13 of affidavit dated January 4, 2016).

[76] The court concludes that the allegation that the shares were sold at an undervalue has not been proven. To say that the shares were not valued cannot rationally lead to a firm conclusion that they were necessarily undervalued. There is no evidence from Ervin or Joni indicating what the shares were valued at the time of their allotment and issuing.

Conclusion and disposition

[77] The declarations sought by the fixed date claim form taken out by Joni are refused. The claim sought by Zip in the ancillary claim is refused. Cost of the

fixed date claim form to the second defendant and to be paid by the claimant. Costs of the ancillary claim to the first ancillary defendant to be paid by the ancillary claimant.