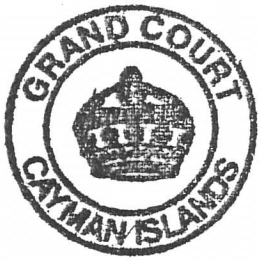


IN THE GRAND COURT OF THE CAYMAN ISLANDS

CAUSE NO: GC0247 OF 2008

14-04-09

BETWEEN:

RENOVA RESOURCES PRIVATE EQUITY LIMITED
(A company incorporated in the Bahamas suing as shareholder of the Second Defendant, Pallinghurst (Cayman) General Partner LP (GP) Limited)

Plaintiff

AND

(1) BRIAN PATRICK GILBERTSON

(2) PALLINGHURST (CAYMAN) GENERAL PARTNER LP (GP)

(3) PALLINGHURST (CAYMAN) GENERAL PARTNER LP

(4) PALLINGHURST RESOURCES MANAGEMENT LP

(5) AUTUMN HOLDINGS ASSET INC.

Defendants

Coram: The Hon. Mr. Justice Foster

Appearances: Richard Millett Q.C. and James Eldridge instructed by Maples and Calder for the Plaintiff
Robert Myles Q.C. and Alain Choo Choy Q.C. instructed by Mourant Du Feu & Jeune for the First and Fifth Defendants

Heard on 26th and 27th February 2009

RULING

1. This is an application by the plaintiff pursuant to GCR O.15, r.12A (2) for leave to continue a derivative action in which the first and fifth defendants have given notice of intention to defend.

2. The relevant parts of GCR O.15, r.12A provide as follows:

> *(i) This rule applies to every action begun by writ by one or more shareholders of a company where the cause of action is vested in the company and relief is accordingly sought on its behalf (referred to in this rule as a "derivative action").*
>
> *(ii) Where a defendant in a derivative action has given notice of intention to defend, the plaintiff must apply to the Court for leave to continue the action.*
>
> *(iii) The application must be supported by an affidavit verifying the facts on which the claim and entitlement to sue on behalf of the company are based.*

The rule then makes various provisions concerning service and other procedural matters and continues:

> *(8) On the hearing of the application under paragraph (2), the Court may –*
>
> *(a) grant leave to continue the action, for such period and upon such terms as the Court may think fit;*

(b) *subject to paragraph (11)* [which makes provisions for when only part of the relief claimed is sought on behalf of the Company], *dismiss the action,*

(c) *adjourn the application and give such direction as to joinder of parties, the filing of further evidence, discovery, cross examination of deponents and otherwise as it may consider expedient*

After making such certain further provisions the rule continues:

(13) The Plaintiff may include in an application under paragraph (2) an application for an indemnity out of the assets of the company in respect of costs incurred or to be incurred in the action and the Court may grant such indemnity upon such terms as may in the circumstances be appropriate.

3. The plaintiff's application for leave to continue the action is strongly opposed by the first and fifth defendants and several issues arise for determination. Firstly, there is the question of the test which the Court should adopt in considering whether to grant leave to the plaintiff in a derivative action to continue the action. Secondly, there is the issue of whether on the material before the Court the plaintiff has met that test. Thirdly, there is the question whether a derivative action may be brought by a shareholder in the holding company of the company (or in this case the exempted limited partnership) which is its ultimate subsidiary

and in which, at least arguably, the cause of action against the defendant(s) is vested. Such an action is usually described as a multiple derivative action. There is also a question as to whether such a shareholder in a holding company may claim for loss or damage which, having arguably been sustained by a subsidiary company, is reflective loss. These are the principal issues arising in this matter but there are other peripheral issues as well.

The Derivative Action

4. The concept of a derivative action is well established in this jurisdiction, as in other Commonwealth jurisdictions. In the leading judgment of the Court of Appeal in Schultz v Reynolds and Another [1992-1993] CILR 59, Zacca P. referred to the well-known English authorities which he clearly accepted as reflecting also the law of the Cayman Islands. He started with the general principle established in Foss v Harbottle [1843] 2 Hare 461 which is *"that where a wrong has been done to a company, prima facie the only proper plaintiff is the company itself and that an action by a shareholder claiming relief for the company is not available. The Plaintiff may only bring a derivate action if it falls within the exceptions to the rule in Foss v Harbottle"*. That the concept of a derivative action is an exception to that principle is explained in the judgments in Edwards v Halliwell [1950] 2 ALL ER 1068; Wallersteiner v Moir (No. 2) [1975] QB 373 and Prudential Assurance Co. Ltd. v Newman Industries Ltd. (No. 2) [1981] Ch. 275. The President referred to the judgment of Jenkins, LJ in Edwards v Halliwell where he said:

It has been further pointed out that where what has been done amounts to what is generally called in these cases a fraud on the minority and the wrongdoers are themselves in charge of the company, the rule is relaxed in favour of the aggrieved minority who are allowed to bring what is known as a minority shareholders' action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue. Those exceptions are not directly in point in this case, but they show, especially the last one, that the rule is not an inflexible rule and that it will be relaxed where necessary in the interests of justice.

In Wallersteiner v Moir (No. 2) (ibid) Lord Denning MR clearly explained why a derivative action should be available where a company is controlled by the alleged wrongdoers:

But suppose [the company] *is defrauded by insiders who control its affairs – by directors who hold a majority of the shares – who then can sue for damages? Those directors are themselves the wrongdoers. If a board meeting is held, they will not authorize the proceedings to be taken by the company against themselves. If a general meeting is called, they will vote down any suggestion that the company should sue them themselves. Yet the company is the one person who is damnified. It is the one person who can sue. In one way or the other some means*

must be found for the company to sue. Otherwise the law would fail in its purposes. Injustice would be done without redress.

He also said in a passage also cited by the President:

Stripped of mere procedure, the principle is that, where the wrongdoers themselves control the company, an action can be brought on behalf of the company by the minority shareholders, on the footing that they are its representatives, to obtain redress on its behalf. I am glad to find this principle well stated by Professor Gower in his book on companies in words which I would gratefully adopt:

> *"Where such an action is allowed the member is not really suing on his own behalf nor on behalf of the members generally, but on behalf of the company itself. Although..... he will have to frame his action as a representative one on behalf of himself and all the members other than the wrongdoers, this gives a misleading impression of what really occurs. The plaintiff shareholder is not acting as a representative of the other shareholders but as a representative of the company..... in the United States..... this type of action has been given the distinctive name of a "derivative action", recognizing that its true nature is that the individual*

member sues on behalf of the company to enforce rights derived from it".

The test which the Court should apply

5. The requirement that the plaintiff in a derivative action in which the defendant has given notice of intention to defend must apply to the Court for leave to continue the action was introduced in the Grand Court Rules of 1995. It had previously been introduced in England in the Rules of the Supreme Court, then in the CPR and is apparently now in their Companies Act 2006. The reason for its introduction was to provide a safeguard to prevent vexatious or inappropriate claims which it was not in the interests of the company concerned to pursue. Prior to the introduction of the requirement in the Rules for the plaintiff to obtain leave to continue, a defendant's only recourse was to apply to strike out the action or to have the plaintiff's entitlement to bring the derivative action determined as a preliminary issue. There is, however, little reported guidance as to the test which the Court should apply in determining whether the plaintiff should have leave to continue the action. There is no reported authority in this jurisdiction. (Schultz v Reynolds (ibid) was before the rule was introduced and in any event the issue in that case was whether the plaintiff as beneficial owner rather than legal owner of shares in the company could bring a derivative action. However, in England, prior to the introduction there of the equivalent of GCR O.15, r.12 A, at common law the plaintiff was required to satisfy the court that he had a prima facie case in order to justify proceeding with such a claim. In fact there are two elements to

this: the plaintiff required to show prima facie firstly that there was a viable cause of action vested in the company and, secondly, that the alleged wrongdoers had control of the company (or could block any resolution of the company or the board) and thereby prevent the company bringing an action against themselves. In Prudential Assurance v Newman Industries (ibid) the English Court of Appeal said (page 221):

In our view, whatever may be the properly defined boundaries of the exception to the rule [in Foss v Harbottle (ibid)], *the plaintiff ought at least to be required before proceeding with his action to establish a prima facie case (i) that the company is entitled to the relief claimed and (ii) that the action falls within the proper boundaries of the exception to the rule in Foss v Harbottle. On the latter issue it may well be right for the judge trying the preliminary issue to grant a sufficient adjournment to enable a meeting of shareholders to be convened by the board, so that he can reach a conclusion in the light of the conduct of, and proceedings at, that meeting.*

6. With regard to the latter comment, in the present case there would, in my opinion, be no point in adjourning to enable a meeting of shareholders of the company. This is because the first defendant controls 50% of the shares in the company and is one of only two directors of the company, so the outcome of such a meeting would be a foregone conclusion.

7. Since the procedural rule requiring the plaintiff in a derivative action to obtain leave has been introduced, it has apparently continued to be the position of the English courts that a plaintiff in seeking leave to continue should satisfy the court that he has a prima facie case in relation both to the merits of the claim by the company and, secondly, that the alleged wrongdoing has been perpetrated by the majority who are in control or, or are otherwise in a position to prevent the company from pursuing the claim against them. In my opinion, in the present case, if the company has a prima facie viable claim against the first defendant as one of its directors (which I have yet to consider), the case falls within the exception to the rule in Foss v Harbottle (ibid) because, as I have already explained, the first defendant is clearly in a position to prevent the company from bringing such a claim against him. The question, therefore, in the present case is whether the company has a prima facie claim against the first and fifth defendants.

The independent board test

8. However, it was argued on behalf of the first and fifth defendants that there are two limbs to the test which the plaintiff in a derivative action must satisfy in seeking leave to continue. It was submitted that not only must the plaintiff satisfy the Court that the company has a prima facie case against the defendant on its merits but he must also satisfy the Court that, even if the company does have such a case, a hypothetical independent board of the company, acting reasonably, would have brought and proceeded with the case.

9. This submission was largely based on the comments of the judge (Warren J.) in Airey v Cordell [2006] EWHC 2728 (Ch 785). That case concerned an application by a minority shareholder in a company to carry on a claim as a derivative action in relation to alleged breaches of duty by the directors in diverting a corporate opportunity of the company in which he was a shareholder to a new company owned by them in which he was neither a shareholder nor a director. The defendant directors accepted that there was a prima facie case against them and that the case was in principle within the exception to the rule in Foss v Harbottle (ibid) to enable a derivative claim. However, they argued that the test to be applied by the court in deciding whether to allow a derivative claim to continue was based on what a reasonable, independent board of directors would do and they contended that an independent board would not have sued the directors but would have waited for developments and, if the corporate opportunity concerned was successful, then sued for an account of profits. In his judgment the judge set out the background to the case in some detail, in particular the various proposals by the defendant directors pursuant to which, they argued, the claimant would be allowed to share in the profits derived from exploiting the corporate opportunity. They contended this was the real complaint of the complainant rather than that the company itself was being deprived of such benefit. As the judge commented, as a matter of legal analysis, the way in which the complainant shareholder conceived that he could share in the benefit of the corporate opportunity was to make sure that it was retained by the company in

which he was a shareholder and its subsidiary, an analysis which, as will be seen, is not wholly dissimilar from that in the present case.

10. Having reviewed Wallersteiner v Moir (No. 2) (ibid) and Prudential Assurance Co. Ltd. v Newman Industries (No. 2) (ibid) the judge said:

As I said, it is a minimum of a prima facie case in relation to (i) and (ii) so the case may clearly be within the exception to Foss v Harbottle, for instance because, if there is a breach of duty, it is clearly one perpetrated by the majority who are in control, but there may nonetheless be a very weak case on the part of the company itself if it brought proceedings, so that if it did not even amount to a prima facie case the derivative proceedings would not be allowed to continue".

As I have already said, it is my view that the present case does fall within the exception to Foss v Harbottle and I did not understand counsel for the parties to argue otherwise. However, the judge in Airey v Cordell then went on to refer to the comments of the judge in Smith v Croft [1986] 1 WLR 580 which was an application in a derivative action for an indemnity by the company of the plaintiff shareholder's costs of the action down to discovery. The judge in that case (Walton J) said:

"Of course there is no room for a mini trial, of course the court has no ability at this stage to decide the truth of the plaintiffs' allegations. What, however, it can

and should do is to look at all the facts, those which are common ground, then those alleged by the plaintiff but denied by the company, and then those alleged by the company but denied by the plaintiff and make up its mind. The standard suggested by Buckley LJ in Wallesteiner v Moir (No. 2) was that of an independent board of directors exercising the standard of care which prudent businessmen would exercise in their own affairs. Would such an independent board consider that it ought to bring the action?".

As the judge in Airey v Cordell emphasized, that was said in relation to an application for an indemnity against costs and not in relation to an application to strike out the derivative action. Nonetheless, after considering Mumbray v Lapper [2005] EWHC 1152 (Ch.) he concluded as follows:

"My conclusion in agreement with Judge Reid is that the appropriate test for bringing proceedings is indeed the view of the hypothetical independent board of directors, but I am also of the view that it is not for the court to assert its own view of what it would do if it were the board, but it merely has to be satisfied that a reasonable board of directors could take the decision that the minority shareholder applying for permission to proceed would like it to take, and I do not think it would be right to shut out the minority shareholder on the basis of the court's, perhaps inadequate, assessment of what it would do rather than a test which is easier to apply, which is whether any reasonable board could take that decision.

If no reasonable board would bring the proceedings, even though there is a prima facie case, then the court should not sanction the minority shareholder's action. This may mean that the introduction of a requirement for permission first in the Rules of Supreme Court and now in CPR, has narrowed the range of cases which can now be brought compared with the minimum standard that the Prudential case might appear to have laid down and the sort of case which it at least seems possible but Buckley LJ seems to think might have been permitted to continue, not with the sanction of the court but simply to continue at the decision of the minority shareholder at his own risk as to costs.

11. The judge's decision on the facts of that case, was that it could not be said that no reasonable board would not pursue the directors by litigation. However, he went on to stay the action to allow the parties to attempt to agree a detailed proposal whereby the claimant shareholder would be given an interest under the directors' new arrangements which would adequately reflect his interest in the company and its subsidiary.

12. With due respect, it does not seem to me that the conclusion of the judge in Airey v Cordell that the test for approving the continuance of a derivative claim is the view of the hypothetical independent board of directors is appropriate and in my opinion it does not represent the law in this country. The basis for the judge's view is that he considers that the test to be applied in considering whether a shareholder may continue a derivative action and the test to be applied in

considering whether a shareholder should have an indemnity from the company for his costs of such an action should be the same. His analysis relies on comments by Buckley LJ in Wallersteiner v Moir (No. 2), which was itself a case concerning *inter alia* an application for an indemnity of the shareholder's costs by the company, when he said, by analogy with the position in a Beddoe application by a trustee (which is, of course, an application for indemnity for costs out of the trust fund):

"In all the instances mentioned the right of the party seeking indemnity to be indemnified must depend on whether he has acted reasonably in bringing or defending the action as the case may be: see for example, as regards a trustee, In Re Beddoe [ibid]. *It is true that this right of a trustee, as well as that of an agent, has been treated as founded in contract. It would, I think, be difficult to imply a contract of indemnity between a company and one of its members. Nevertheless, where a shareholder has in good faith and on reasonable grounds sued as a plaintiff in a minority shareholder's action, the benefit of which, if successful, will accrue to the company and only indirectly to the plaintiff as a member of the company, and which it would have been reasonable for an independent board of directors to bring in the company's name, it would, I think, clearly be a proper exercise of judicial discretion to order the company to pay the plaintiff's costs. This would extend to the plaintiff's costs down to judgment, if it would have been reasonable for an independent board exercising the standard of care which a prudent businessman would exercise in his own affairs to continue the action to*

judgment. If, however, an independent board exercising that standard of case would have discontinued the action at an earlier stage, it is probable that the plaintiff should only be awarded his costs against the company down to that stage".

13. Buckley LJ then went on to propose a procedure (this was, of course, before the rule in England from which GCR O.15, r.12A (2) is derived came into effect), analogous to the procedure adopted by a trustee pursuant to In Re Beddoe by way of an ex parte application at which the merits of the case may be discussed with the court and the court, if it considers it appropriate, may give directions as to whether the company or other minority shareholder or the defendants or anyone else should be made respondents to the application. However, in the context of derivative proceedings all of this clearly related to an application by the plaintiff shareholder for an indemnity for his costs of the action from the company. It did not concern directly the appropriate test which the court should adopt in considering whether the plaintiff should have leave to commence or continue the action. In fact what Buckley LJ said about that in the passage to which I have referred was *"where a shareholder has in good faith and on reasonable grounds sued as a plaintiff in a minority shareholder's action..."* which suggests he considered that the appropriate circumstances were when the minority shareholder sued in good faith and on reasonable grounds. It seems to me that "reasonable grounds" is very similar to a prima facie case. The test for bringing or continuing a derivative action was first specifically considered and explained in the

Prudential Assurance case some 6 years later when, in the passage from the English Court of Appeal judgment to which I have already referred, the court gave their view that the plaintiff in a derivative action ought at least be required before proceeding to establish a prima facie case that the company is entitled to the relief claimed and that the action falls within the exception to the rule in Foss v Harbottle.

14. In the present case there was and is no application by the plaintiff for an indemnity of its costs of the action by the company and I was informed that it is not intended to make one. Accordingly the issue in Wallersteiner v Moir on which the judge in Airey v Cordell relied does not arise. The conclusion of the judge in Airey v Cordell is apparently derived from the case of Mumbray v Lapper (ibid) in which the judge in that case, having considered the relevance of the shareholder claimant's conduct and of the availability of an alternative remedy, stated:

"The central question in any case such as this is "would an independent board sanction pursuit of the proceedings?"

15. I was referred by counsel for the plaintiff to the judgments of the Court of Final Appeal of Hong Kong in Waddington Limited v Chan Chun Hoo Thomas and Others, 8th September 2008 (unreported). In his judgment Ribeiro PJ said:

"The derivative action is a procedural device invented by the courts to afford protection to the minority. Procedurally, there is no requirement at common law for a person seeking to sue derivatively first to obtain leave from the court. But it does not follow from this that there is no threshold requirement to be met by the plaintiff. Substantively, such an action is only permitted where it can prima facie be shown that there exists a viable cause of action or equitable claim vested in the company which, if made good, would establish a fraud on the minority; as well as control of the company by the alleged wrongdoers such as to enable them to stifle any proposed action against themselves.

Having explained the procedural practice at common law he went on to say:

It is in such a context that the court has to consider whether the self-appointed derivative plaintiff should be permitted to proceed with the action by way of exception to the proper plaintiff rule.

He then referred to the Prudential Assurance case and the conclusion of that court which he summarised as *"the answer was for a prima facie case test to be adopted, coupled with the possibility of seeking the views of the company in general meeting where appropriate"*. Having referred also Smith v Croft (ibid) he said *"this has continued to be the approach of the English courts"*, and referred in a footnote to, among others, Airey v Cordell (ibid).

16. After explaining that the prima facie test has also been adopted in Hong Kong, Ribeiro PJ continued:

"The common law rule is therefore that a plaintiff whose standing to bring a derivative action is challenged must establish a prima facie case that the company is entitled to the relief claimed and that the action falls within an applicable exception to the rule in Foss v Harbottle (usually the fraud on the minority exception). Where, as often occurs, the plaintiff seeks an order to be indemnified as to costs by the company which may benefit from the derivative action, the court's approach is to consider whether and to what extent an honest independent and prudent board might decide to authorize prosecution of the action, given the available evidence.

And he referred as support for his comments again to Airey v Cordell (ibid) as well as Wallersteiner v Moir (No. 2) and Smith v Croft (ibid)

17. In the same case Lord Millett NPJ said:

"The solution which the Court of Appeal found in Prudential was to require the plaintiff, whether at the trial of a preliminary issue or on an application to strike out the proceedings, to establish a prima facie case both that the company was entitled to the relief claimed and that the plaintiff was entitled to bring the claim on its behalf by way of a derivative action. In an appropriate case the court could

adjourn the proceedings in order to ascertain whether the independent shareholders considered that it was in the interests of the company to pursue the claim.

This approach was followed in Smith v Croft (No. 2) (ibid) *and was subsequently adopted by the Rules Committee when the Rules of the Supreme Court were amended by adding O.15, r.12A (later CPR R.19.9 and now S.260 of the Companies Act 2006). This imposed a requirement for the plaintiff in a derivative action to obtain the leave of the court to continue the action, thereby providing the filter which had been discarded more than a century earlier. The plaintiff has consistently been required on the application for leave to establish a* prima facie *case both that the company would be likely to succeed if it brought the action itself and that the case falls within an exception to the rule in* Foss v Harbottle*".*

18. I respectfully agree with the statements of Ribeiro PJ and Millett NPJ. It does not in my view follow, as suggested in Airey v Cordell, that the test to be adopted in considering whether a shareholder should have leave to proceed with a derivative action and the test to be adopted in considering whether a shareholder plaintiff in a derivative action should have an indemnity for his costs from the company should necessarily be the same. The circumstances and the considerations seem to me to be different. In an application for leave to continue a derivative action there are not inevitably financial consequences for the company. The only issue is, or should be, whether there is a prima facie case, firstly that the claim falls

within the exception to the rule in Foss v Harbottle and, secondly, on the merits against the defendant. The purpose of this "filter", as Millett NPJ described it, is to satisfy the court that there are reasonable grounds for the plaintiff's claim and that it is not vexatious or frivolous or has no real prospect of success. In an application for an indemnity for costs by the company there are obviously potential financial consequences for the company. One can see that in such circumstances consideration of whether a hypothetical independent board of directors would be likely to approve the incurring of such costs would be appropriate in determining that issue. But where the only issue is whether the plaintiff should have leave to continue the action there is no risk to the company and, in my view, no need to be concerned with the views of a hypothetical board.

19. In my opinion the appropriate test for this Court to adopt in considering an application for leave to continue a derivative action is the prima facie case test, that is, where a defendant in a derivative action has given notice of intention to defend, the plaintiff must satisfy the Court that the company has a prima facie case against the defendant (and that the action falls within an applicable exception to the rule in Foss v Harbottle). Even if I am wrong about this there was anyway no evidence before me to indicate that a hypothetical honest, independent and prudent board of directors could or would not have proceeded with the claim of the company if such a board was satisfied that there was a prima facie case. I propose to consider the plaintiff's application on the basis of the prima facie case test.

Standard of a prima facie case

20. There does not appear to have been any precise analysis in the English case law of the standard of a prima facie case in this context. In the Prudential Assurance case (ibid), in the passage which I have already quoted, it was made clear that the right to progress a minority action is not to be equated with the absence of grounds for a strike out in ordinary litigation. It has also been made clear that a prima facie case is more than a good arguable case. It is also clear that the hearing of such an application for leave *"must not be allowed to turn in to a mini trial, but the court must nevertheless have sufficient evidence before it is able to make a careful assessment of the merits"* – see English Supreme Practice 1999 Vol. 1, note 15/12A/4. Counsel for the plaintiff accepted that the plaintiff must do more than merely show that the case cannot be struck out but he also submitted that the plaintiff does not have to prove its case on the evidence as if this were a trial, which in my view must be right. However, he also argued that the appropriate question is whether, if the defendants were to choose not to defend, the claim would be more likely than not to succeed on the pleaded case and the material before the court. That seems to me to amount to submitting in effect that the court should proceed as if the pleaded case was true and ignore the evidence submitted by the defendants, which does not accord with my understanding of the authorities.

21. The purpose of requiring the plaintiff to obtain leave to continue the derivative action, as I understand it, is to prevent the expense and time of and to protect the

defendants against vexatious or unfounded litigation which has little or no prospect of success or which is clearly brought by an aggrieved shareholder for his own reasons rather than in the interests of the company. The phrase "prima facie" has various shades of meaning but literally means "at first sight". Given that there is not to be a mini trial of the plaintiff's case, it seems to me that I must form a view of the plaintiff's case based on my first impressions having regard to my assessment of all the evidence before me, including that submitted by the defendants. For the plaintiff to obtain leave to continue with the action I consider that I must be satisfied in the exercise of my discretion that its case is not spurious or unfounded, that it is a serious as opposed to a speculative case, that it is a case brought *bona fide* on reasonable grounds, on behalf of and in the interests of the company and that it is sufficiently strong to justify granting leave for the action to continue rather than dismissing it at this preliminary stage.

22. **The Parties**

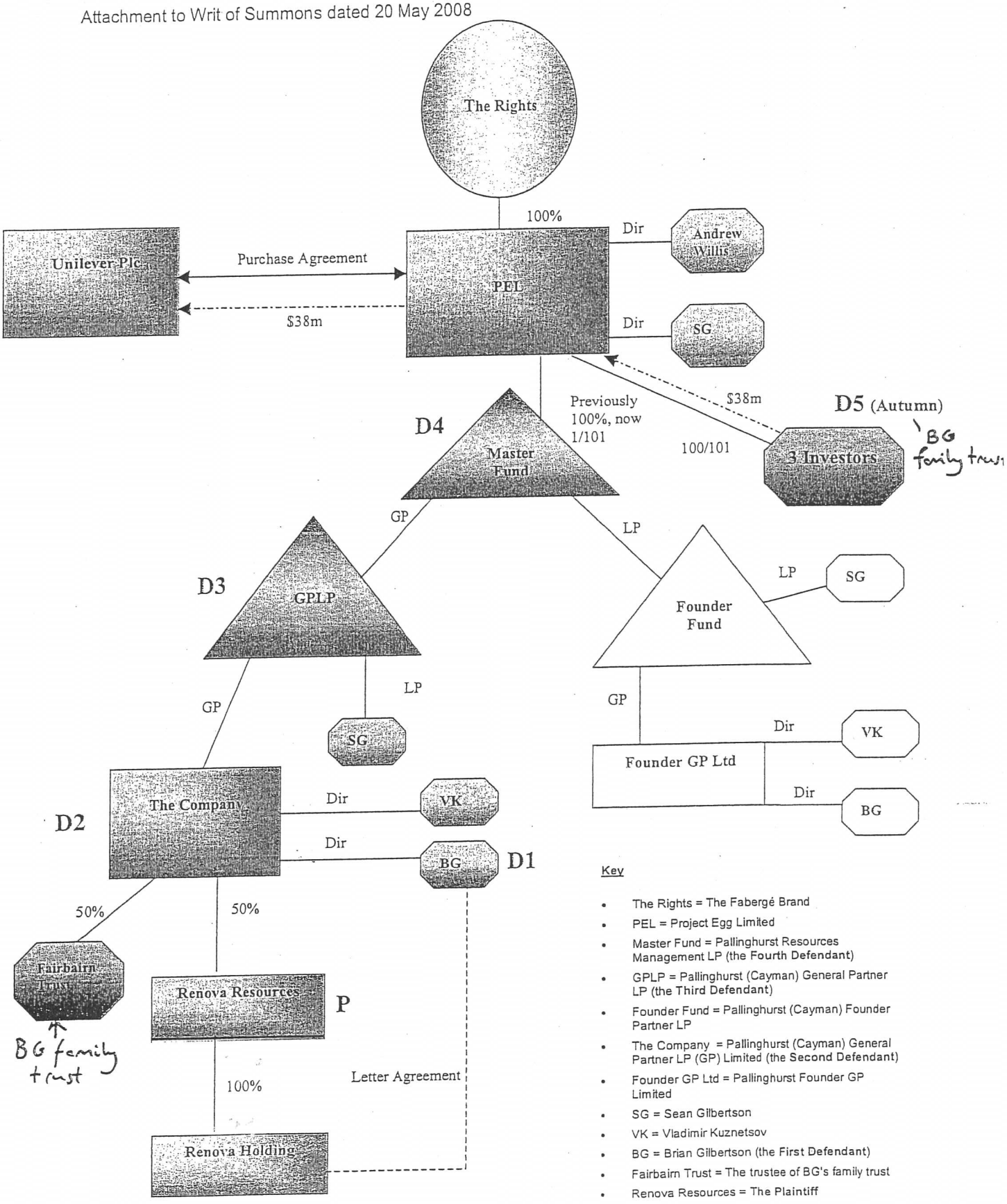
(1) The plaintiff, Renova Resources Private Equity Limited, is a company incorporated in the Bahamas. It is wholly owned by Renova Holding Ltd., ("Renova Holding") which is a Bahamian holding company and a member of the Renova Group of companies ("the Renova Group"). The Renova Group is ultimately controlled by Mr. Viktor Vekselberg. The plaintiff is the holder of 50% of the shares in the second defendant company, Pallinghurst (Cayman) General Partner LP (GP) Limited, ("the Company"). It is on behalf of the Company that the plaintiff purports to bring this derivative action. The Company

is incorporated in the Cayman Islands. The holder of the other 50% of the shares in the Company is Fairbairn Trust Limited, which is effectively controlled by the first defendant, Mr. Brian Gilbertson ("Mr. Gilbertson"). There are two directors of the Company, Mr. Gilbertson and Mr. Vladimir Kuznetsov ("Mr. Kuznetsov"), who is the investment director of another member company of the Renova Group.

(2) The Company is the general partner of a Cayman Islands exempted limited partnership called Pallinghurst (Cayman) General Partner LP ("GPLP"), the third defendant. GPLP is in turn the general partner of the fourth defendant, another Cayman Islands exempted limited partnership called Pallinghurst Resources Management LP ("The Master Fund").

(3) The fifth defendant ("Autumn") is a British Virgin Islands Company also wholly owned by Fairbairn Trust Limited and therefore a Gilbertson entity.

(4) For convenience a diagram of this structure and related entities and individuals as set out in the plaintiff's statement of claim, with some minor clarifying annotations by me is set out below.



Key

- The Rights = The Fabergé Brand
- PEL = Project Egg Limited
- Master Fund = Pallinghurst Resources Management LP (the Fourth Defendant)
- GPLP = Pallinghurst (Cayman) General Partner LP (the Third Defendant)
- Founder Fund = Pallinghurst (Cayman) Founder Partner LP
- The Company = Pallinghurst (Cayman) General Partner LP (GP) Limited (the Second Defendant)
- Founder GP Ltd = Pallinghurst Founder GP Limited
- SG = Sean Gilbertson
- VK = Vladimir Kuznetsov
- BG = Brian Gilbertson (the First Defendant)
- Fairbairn Trust = The trustee of BG's family trust
- Renova Resources = The Plaintiff

23. This structure was established pursuant an agreement between Renova Holding and Mr. Gilbertson contained in a letter dated 24th November 2005 ("the Letter Agreement"). Mr. Gilbertson was employed by a Renova Group entity in Russia and the preamble to the Letter Agreement states that it sets out conditions relating to the granting by Renova Holding of certain "incentive units", being notional shares in another Renova Group company, to Mr. Gilbertson. Pursuant to the Letter Agreement Renova Holding was to set up, and duly did set up, the structure at its cost and Renova Holding and Mr. Gilbertson were to work together to add value to the Master Fund. The purpose of the Master Fund was to explore, acquire and develop opportunities in the metal and mining industry. As can be seen, the structure involved the setting up of the Master Fund, GPLP and the Company, with the Company as the general partner of GPLP and, through it, ultimately the Master Fund. This structure was known throughout as the Pallinghurst Structure.

24. The Letter Agreement provided *inter alia* that Mr. Gilbertson's duties with (what became) the Master Fund, GPLP and the Company would be those customarily (sic) for an Executive Chairman of a company, and they would include, but not be limited to:

> *"2.3.1 establishing infrastructure, management and staffing arrangements as appropriate;*

2.3.1 searching for and introducing Investment Projects to the Investment Committee;

2.3.2 supervising of the implementation of the approved Investment Projects;

2.3.3 selecting of managers and managing partners for Investment Projects subject to any conditions contained in the Investment Committee's approval of the Investment Project;

2.3.4 providing strategic advice on corporate development of the Investment Fund, Fund Management Vehicle and Investment Projects".

25. It should perhaps be noted that the Letter Agreement also defined Mr. Gilbertson and Renova Holding as partners and paragraph 2.2 provided that:

"The partners will work together to add value to the Investment Fund (which became the Master Fund). To this end, and subject to the consent required pursuant to clause 3.2 of the Employment Agreement, you will forthwith be appointed the Chairman of the Investment Fund and the Fund Management Vehicle until the fourth anniversary of the Commencement Date. In these capacities, you will assume responsibility for developing and implementing the strategy for the Investment Fund and for all Investment Projects....."

The plaintiff's case

26. The complaint which the plaintiff seeks to bring on behalf of the Company by way of the derivative action is that Mr. Gilbertson, who was at all material times a

director of the Company, acted in breach of his fiduciary duties to the Company by diverting away from the Company a valuable opportunity to acquire from Unilever PLC the benefit of exploiting the rights to the Fabergé brand ("the Rights"). This opportunity to acquire and exploit the Rights became known as "Project Egg".

27. The plaintiff also alleges that Autumn (which is a family entity of Mr. Gilbertson's) participated in this diversion of assets by, unknown to the Company, providing part of the funding for the purchase of the Rights and acquiring substantial shares in the company which acquired the Rights, Project Egg Limited ("PEL"), in consideration for such funding. The plaintiff contends that Autumn made this investment and received shares in PEL, knowing that the dilution of the Master Fund's 100% ownership of PEL and the issue of new shares in PEL, inter alia to Autumn, was a breach of fiduciary duty by Mr. Gilbertson and that consequently Autumn received its shares in PEL as a constructive trustee for the Master Fund and the Pallinghurst Structure.

28. The plaintiff pleads that as a director of the Company Mr. Gilbertson owed fiduciary duties to the Company, including the duties to act in good faith, in the best interests of the Company, not to place himself in a position where his duties to the Company and his own interests might conflict and to refrain from self-dealing. The plaintiff also contends that Mr. Gilbertson's actions amounted to making a secret profit and that he had a duty to account for such profit. The

plaintiff pleads that Mr. Gilbertson is in breach of all of these duties and that, as explained above, Autumn is also liable to account as a constructive trustee.

29. The plaintiff's case is that the Company, for itself and in its capacity as the general partner of GPLP and, in turn, the Master Fund, is entitled to and seeks on behalf and in the interest of the Company and its subsidiary limited partnerships various relief against Mr. Gilbertson and Autumn, including an account of profits and equitable compensation. It also seeks an order that the first and fifth defendants pay the Company and/or GPLP and/or Master Fund interest and also all such orders and directions as may be just and convenient, including any orders or directions as to such claims as may be brought by GPLP and/or the Master Fund.

30. In support of the plaintiff's application for leave to continue the action two affidavits by Mr. Kuznetsov, the other director of the Company, were filed. An affidavit in opposition to the plaintiff's application was filed by Mr. Gilbertson and Mr. Kuznetsov then filed his 3rd affidavit in reply to that. A significant amount of documentation was exhibited to the affidavits including, in particular, a considerable number of email exchanges between the parties involved. There are disputes between the parties over the interpretation of this correspondence and as to the proper interpretation of the actions of Mr. Gilbertson and, to some extent, of Renova Holding and those behind it, in all the circumstances.

The history of the dispute

31. The background to the acquisition of the Rights and their ultimate ownership and control by PEL, with PEL being owned by Autumn and two other investors, all unrelated to the Pallinghurst Structure, rather than being held and controlled by the Master Fund and ultimately the Company pursuant to the Pallinghurst Structure is relatively complicated. I do not consider it necessary or appropriate on an application of this kind to go into all the fine detail and nuances which were urged upon me. I shall endeavour to summarize as best I can, I hope without doing any grave injustice to the different analyses of counsel, a fairly complex history.

32. The acquisition of the Rights from Unilever was initially proposed by Mr. Gilbertson as an interesting investment before the Pallinghurst Structure was set up. Clearly it was not an investment of the kind contemplated for the Pallinghurst Structure by the Letter Agreement. However, in due course it was nonetheless proposed as an investment for the Pallinghurst Structure. It was argued on behalf of Mr. Gilbertson that, having regard to the terms of the Letter Agreement of the Company and Mr. Gilbertson's duties thereunder, and to the fact that the Rights did not constitute an investment opportunity of the kind contemplated, he consequently owed no duties to the Company in respect of the Rights and was free to exploit the opportunity for himself. However, my impression of the evidence overall is that all parties, at least until much nearer the time of the actual purchase of the Rights from Unilever, were in fact proceeding upon the basis that

the Rights were to be acquired by the Master Fund and held pursuant to the Pallinghurst Structure. In late 2006, only a matter of weeks before 3 January 2007, which Mr. Gilbertson or his son had agreed with Unilever as the date for completion of the purchase of the Rights, a special purpose vehicle, PEL, owned 100% by the Master Fund was incorporated by Mr. Gilbertson or his son to acquire the Rights. Generally speaking, apart from a few indications otherwise, all seems to have proceeded on this basis until about mid December 2006 with Mr. Gilbertson's son, negotiating a final purchase price of US$38m for the Rights with Unilever. The price was at that stage to be paid by the Renova Group. The issues between the parties seem to me to really arise from about 20th December 2006.

33. Although the plaintiff contends that the proposal was raised prior to 20th December 2006, on that date the Deputy Chief Legal Officer of Renova Management, another company in the Renova Group, informed Mr. Gilbertson's son that the ownership of the Rights was to be held by another company in the Renova Group, Lamesa Arts Inc. ("Lamesa"), outside the Pallinghurst Structure while the economic benefit of exploiting and the management and control of the Rights would remain within the Pallinghurst Structure as intended. There is substantial dispute between the parties as to what occurred thereafter and the consequences of that. The plaintiff's case is that this proposal was accepted and agreed by Mr. Gilbertson, and that subsequently, pursuant to such agreement several drafts of an agreement setting out the terms on which this proposed

structure would be effected were circulated between the parties without objection on the part of Mr. Gilbertson. This was an agreement whereby the ownership of the Rights would be held by (or transferred to) Lamesa with the economic benefit and management of the Rights being held within the Pallinghurst Structure, through the Master Fund. This would involve payment of the purchase price for the Rights by Lamesa (as I have mentioned already it had always been intended that the purchase price would be paid by a company in the Renova Group). The plaintiff contends that sometime during 21st or 22nd December 2006 Mr. Gilbertson unilaterally and without any notice to the Company procured the execution of the purchase agreement for the Rights by PEL, agreeing that PEL would pay the purchase price to Unilever on or before 3rd January 2007. Notwithstanding this, on 23rd December 2006 Mr. Gilbertson sent an email to Mr. Vekselberg, the principal of the Renova Group, confirming his willingness to transfer ownership of the Rights through PEL to Lamesa against a binding commitment that the Pallinghurst Structure would retain the economic benefit of and powers to manage the Rights. The plaintiff argues that this amounted to clear agreement by Mr. Gilbertson that the economic benefit of the Rights and control of the Rights would and should be held within the and for the benefit of the Pallinghurst Structure while the ownership of the Rights would be with Lamesa. As I understand it, the economic benefit from and the ability to manage an investment would accord with the purpose behind the acquisition of an approved investment pursuant to the Letter Agreement and the Pallinghurst Structure. The intent of the Pallinghurst Structure was to enable, ultimately the Company, and

thus the shareholders of the Company, to benefit from the acquisition and management and control of investments held by and through the Master Fund.

34. However, by an email on 2nd January 2007 Mr. Gilbertson, without any previous indication, intimated by email that he had made alternative arrangements and that payment of the purchase price for the Rights had been made to Unilever. Without the knowledge or consent of the Company or the plaintiff as his co-shareholder, Mr. Gilbertson procured the acquisition of the Rights by PEL and almost immediately procured the issue of new shares in PEL to 3 investors, one of whom was Autumn, who had between them paid the purchase price of US$38m for the Rights, leaving the Master Fund as a result with only a nominal interest in PEL and thus in the Rights. The plaintiff claims that as a result of Mr. Gilbertson's actions the Pallinghurst Structure, with the Company at its head, was deprived of the opportunity to enjoy the economic benefit from exploiting and managing the Rights as had been intended through the Master Fund, the Master Fund having now been reduced by Mr. Gilbertson's actions to holding less than 1% of the issued shared capital of PEL. As explained above, the plaintiff pleads that this amounted in several respects to breach of duty by Mr. Gilbertson as a director of the Company.

35. Mr. Gilbertson's interpretation of and contentions in relation to events, particularly after 20th December 2006 is quite different. He contends that once the Renova Group had demanded that ownership of the Rights should be held

outside the Pallinghurst Structure and Mr. Vekselberg had declined to fund the purchase of the Rights from Unilever unless they were owned by an entity of his choosing outside the Pallinghurst Structure, Mr. Gilbertson ceased to have any fiduciary duties towards the Company. He contends that he was in effect coerced into endeavouring to negotiate a possible variation of the intended arrangements with the Renova Group pursuant to the Letter Agreement in order to achieve a new structure to accommodate Mr. Vekselberg's personal wishes that one of his companies actually own the Rights, that he in effect should be able to say he owned the Fabergé brand. Mr. Gilbertson contends that procuring PEL to enter into the purchase agreement with Unilever was not contrary to the intent behind the Pallinghurst Structure nor prejudicial to the Company. At that point PEL was wholly owned by the Master Fund as always intended. However, Mr. Gilbertson says that by 2nd January 2007 and with completion of the purchase of the Rights due on 3rd January 2007, and with Mr. Vekselberg declining to fund the purchase price unless title to the Rights was held by Lamesa, he decided that he had no choice, if the acquisition of the Rights was to be saved, but to take steps to raise alternative finance himself from two other potential interested investors and from his own family entity Autumn, which is what he did. Those entities were issued shares in PEL in consideration of their payment of the purchase price for the Rights. The consequence was that while the Rights were owned by PEL, instead of PEL being owned wholly by the Master Fund, it then became owned by the three investors, including Autumn, wholly outside the Pallinghurst Structure. Mr. Gilbertson explains his position in his affidavit at paragraph 45 as follows:

"The effect of Lamesa acquiring ownership of the Rights –or for that matter, acquiring ownership and/or control of PEL if PEL acquired the Rights (which was what Renova subsequently proposed) – even if certain defined economic benefits were reserved for the Pallinghurst Structure, would have deprived the Master Fund of the very ownership of the Rights and diluted the amount of control that the Master Fund would have enjoyed over the Rights and their exploitation (for the key asset of value would be owned outside the structure). Such a development ran completely contrary to what I had agreed with Mr. Vekselberg and Renova, both under the Letter Agreement and from the very outset of my introduction of the opportunity to them. During the two years of negotiation to get the deal agreed, there had never been any suggestion whatsoever that the opportunity – or indeed any other – would be held outside of the Pallinghurst Structure. Such a possibility had never even entered my mind".

36. Mr. Gilbertson contends that it was the Renova Group who in fact refused to consent to the acquisition of the Rights through the Pallinghurst Structure and that it was Mr. Gilbertson who had sought and continued to try to achieve that until the very acquisition of the rights was at risk. Mr. Gilbertson points out that further negotiations took place in January and February 2007 after the acquisition of the Rights during which time Mr. Vekselberg and Mr. Kuznetsov continued to maintain their position that ownership of the Rights should not be held within the Pallinghurst Structure and he referred to what was said at a meeting of the directors of the Company on 30th March 2007 and particularly in a letter from

Renova Holdings to Mr. Gilbertson on 25th May 2007. In that letter Renova Holdings state that they had never approved acquisition of the Rights through the Pallinghurst Structure and that Mr. Gilbertson's actions demonstrated that the Pallinghurst Structure was clearly not operating to either party's satisfaction. It was submitted on behalf of Mr. Gilbertson that the plaintiff, a company within the Renova Group, is now bringing the present action on the premise that the Rights were intended to be and should have been brought within the Pallinghurst Structure which is wholly inconsistent with the statements of Renova Holdings in the letter of 25th May 2007 and previously at the meeting in March 2007. I shall return to that point later in this judgment. Mr. Gilbertson's position was that he was prepared to negotiate with the Renova Group representatives to bring the Rights within the Pallinghurst Structure but that he did so not pursuant to any duty to the Company. He had done what he did out of commercial necessity having regard to the need to fund the purchase of the Rights from Unilever and the fact that Mr. Veskelberg and the Renova Group were declining to provide the necessary funding unless it was agreed that title to the Rights would be held by a Renova Group company, namely Lamesa, outside the Pallinghurst Structure. His case is that since the Rights could not be bought within the Pallinghurst Structure as a result of the requirements and attitude of the Renova Group, he was at liberty to exploit Project Egg for himself and that he would only have been precluded from doing so if Project Egg had been approved as an investment project which was to remain wholly within the Pallinghurst Structure, which, he contends, was

not the position of the Renova Group until the plaintiff commenced this action, amounting to a complete about-turn.

37. In reply to these contentions Mr. Kuznetsov questions Mr. Gilbertson's *bona fides* and points out for example, that there is a strong inference that Mr. Gilbertson had planned to take the Rights for himself long before he says he felt obliged to do so on 2nd January 2007 as a result of the requirements of the Renova Group. It was pointed that if Mr. Gilbertson apparently suddenly reached the conclusion on 2nd January 2007 that he had to get alternative funding for the purchase of the Rights and was apparently able to "trigger alternative arrangements" to raise the purchase price of $38m remarkably quickly so as to make payment of the purchase price the following day. It was pointed out that up to 2nd January 2007 drafts of the proposed agreement whereby ownership of the Rights would be held by Lamesa but the economic benefit of the Rights would be held with the Pallinghurst Structure had been circulated between representatives of the Renova Group on the one hand and the Gilbertson's on the other hand without any suggestion that such a structure was unacceptable or not in the best interests of the Pallinghurst Structure. Mr. Gilbertson had in fact expressly confirmed his willingness to agree to such an arrangement whereby PEL, which was then wholly owned by the Master Fund, would have the exclusive right to license, use and exploit the Rights. The plaintiff also points out that, according to Mr. Gilbertson's son, in an email on 21st December 2006, the Master Fund was to guarantee to Unilever the obligations of PEL under the purchase agreement. In

fact, it subsequently became apparent that the guarantor of PEL was not intended to be the Master Fund but another company outside the Pallinghurst Structure wholly owned and controlled by Mr. Gilbertson. This has been attributed by Mr. Gilbertson's London solicitors to a "clerical error", although there was in fact apparently a meeting of Mr. Gilbertson's company on 21st December 2006 at which the draft guarantee agreement was approved and it was agreed that Mr. Gilbertson's company would execute it. The plaintiff contends that all of this strongly suggests that Mr. Gilbertson had plans to take the Rights outside the Pallinghurst Structure for his own benefit at a far earlier stage than 2nd January 2007 as he alleges. Precisely why the negotiations from 21st December 2006 which continued on after the purchase of the Rights on 3rd January 2007 were not successful or who was responsible for such failure is a matter of considerable dispute. The plaintiff contends that it was due to the unreasonable and inappropriate behaviour of Mr. Gilbertson in breach of his duties. Mr. Gilbertson submits that this contention is wholly unjustified. Again, I do not consider it necessary or appropriate to go further into the minutiae of this for present purposes.

Conduct of the plaintiff

38. Mr. Gilbertson also contends that the conduct of the Renova Group renders it inequitable to grant leave to the plaintiff, a member of that group, leave to continue these proceedings. As explained above, Mr. Gilbertson argues that the position taken by the plaintiff in these proceedings that Mr. Gilbertson diverted

the Rights away from the Pallinghurst Structure is inconsistent with the position taken by Renova Holding in 2007 and particularly in its letter of 25th May 2007. He says that this volte face demonstrates that the plaintiff has not brought this action *bona fide* for the benefit of the Company or the Pallinghurst Structure. It is said also on behalf of Mr. Gilbertson that the conduct of Mr. Vekselberg as the ultimate principal of the Renova Group and thus of the plaintiff, in seeking to procure the transfer of the ownership of the Rights outside the Pallinghurst Structure, itself resulted in breaches of duty to the Company by Mr. Kuznetsov, Mr. Gilbertson's fellow director. It was contended that it was Mr. Kuznetsov who acted in breach of his fiduciary duties to the Company by pursuing Mr. Vekselberg's personal agenda rather than the best interests of the Company and the Pallinghurst Structure. It was submitted that in the end of the day the Renova Group have been the authors of their own misfortune by insisting that the Rights should be owned outside the Pallinghurst Structure and that a court of equity should not assist a party who has brought about the very matters complained about.

39. In Nurcombe v Nurcombe [1985] 1 WLR 370 Browne-Wilkinson LJ said, by reference to Towers v African Tug Co. [1904] 1 Ch. 558:

"In my judgment, that case established that behaviour by the minority shareholder, which, in the eyes of the equity would render it unjust to allow a claim brought by the company at his instance to succeed, provides a defence to a

minority shareholder's action. In practice, this means that equitable defences which would have been open to defendants in an action brought by the minority shareholder personally (if the cause of action had been vested in him) would also provide a defence to those defendants in a minority shareholder's action brought by him.

The defendant argues this conduct by the plaintiff shareholder or those behind it renders it inequitable to allow a claim brought by it on behalf of the Company, to proceed.

40. The plaintiff argues that the contentions on behalf of Mr. Gilbertson are a misinterpretation of the facts and that it was always intended by the plaintiff and the Renova Group that the economic benefit and management of the Rights should remain within the Pallinghurst Structure and that it was the actions of Mr. Gilbertson which diverted that economic benefit and control away from the Pallinghurst Structure and thus the Company in breach of his duties to the Company. What is more, the plaintiff says, the Gilbertsons clearly initially agreed with this proposal and entered into negotiations about the precise terms of a draft agreement giving effect to it. There was no suggestion by them at the time that it was not in the best interests of the Pallinghurst Structure or of the Company or that Mr. Gilbertson was somehow released from his duties as a director of the Company as a result. Indeed there was nothing to indicate, until Mr. Gilbertson's email of 2nd January 2007, that everything was not proceeding on this basis and

that the Pallinghurst Structure, with the Company at its head, would not shortly be the owner of the economic benefit and the manager of the Rights. The plaintiff contends that Mr. Gilbertson's real intention from a much earlier stage was to acquire the Rights himself and, as he said himself in an email, to "warehouse" them with a view to then negotiating about the possible return of the Rights to the Pallinghurst Structure from a position of strength. As far as the letter of 25th May 2007 is concerned the plaintiff argued that it is simply not relevant in determining the true position which must be derived from the contemporary communications documentation and actions of the parties and not *ex post facto* at a time when the Renova Group were negotiating months later to resolve a situation caused by Mr. Gilbertson's breaches of duty. The plaintiff contends that the letter does not provide an equitable defence to Mr. Gilbertson of the kind envisaged in the Nurcombe case and that what matters is the conduct of the parties at the relevant time. The plaintiff says the case it pleads represents its position as it was at the material time.

41. In my view the letter of 25th May 2007, and indeed, the comments of Renova Holding in March 2007, while no doubt material for cross examination if the case were to proceed, do not constitute conduct of a kind which, at least at this stage and for this purpose, sufficiently impacts on the *bona fides* and equity of the plaintiff's case such as to satisfy me that in light of it the plaintiff should not have leave to continue the action.

Mr. Gilbertson's duties

42. Counsel for Mr. Gilbertson argued that the Letter Agreement was fundamental to the relationship between Mr. Gilbertson and the Renova Group and that this determined the scope of Mr. Gilbertson's fiduciary duties. Mr. Gilbertson argues that from an early stage it was envisaged that the Rights would be an investment of the Pallinghurst Structure pursuant to the Letter Agreement but that it was the Renova Group who changed this by their insistence that the Rights should be owned by another Renova company, Lamesa. At that point, it is argued, Mr. Gilbertson would have been perfectly entitled to say "no" to that proposal and he had no duty to negotiate an alternative. It was not his duty, it is said, to serve Mr. Vekselberg's interests. In fact Mr. Gilbertson did attempt to reach an accommodation with Mr. Vekselberg in his personal capacity but it was submitted that at that point he was acting as an investor for commercial reasons and not in his capacity as a director of the Company. Mr. Gilbertson contends that latterly the draft agreement proposed by the Renova Group for the new arrangement sought to place restrictions on any future sale by PEL of the economic benefit of the Rights, which would have made it difficult if not impossible for the Master Fund to realize the investment. In the circumstances there could be no breach of Mr. Gilbertson's duties to the Company and there was none.

43. The plaintiff, on the other hand, argues that Mr. Gilbertson had clear duties to the Company as a director to act in the best interests of the Company, to act *bona fide* and honestly and not to place himself in a position where his own interests

conflicted with those of the Company or to make a profit at the expense of the Company. The plaintiff contends that from 20th December 2006 it was clear that the Pallinghurst Structure would retain the economic benefit and control of the Rights and that Mr. Gilbertson agreed in principle with that. It remained his duty, in the best interests of the Company, to ensure that was achieved and not to divert that commercial opportunity to himself. By diverting the economic benefit of the Rights away from the Company and its subsidiary entities in the Pallinghurst Structure, Mr. Gilbertson, it is argued, clearly breached his duties to the Company for his own personal benefit. It is argued that the terms on which the Renova Group would procure the funding of the purchase of the Rights were perfectly reasonable and in the best interests of the Company, even if not acceptable to Mr. Gilbertson personally.

44. Although, there are clearly arguable defences to the claim which the plaintiff makes on behalf of the Company and its subsidiary entities against Mr. Gilbertson for breach of his duties as a director of the Company, I am satisfied that the plaintiff has a prima facie case against Mr. Gilbertson for breach of his duties as a director. The commercial opportunity of acquiring the economic benefit and control of the Rights, while it may not have involved retaining actual title to the Rights as originally contemplated, nonetheless remained a valuable commercial opportunity which it would have been in the interests of the Company to acquire. Prima facie the diversion of that opportunity away from the Company and its subsidiary entities in the Pallinghurst Structure by a director of the Company for

his own personal benefit would be a breach of that director's duties to the Company. My overall assessment of the totality of the affidavit evidence put before me at the hearing in my view supported that prima facie analysis.

Indemnities and exclusions in Articles of Association

45. Apart from his arguments as summarized above, Mr. Gilbertson also claims that as a director of the Company he has the benefit of indemnities and exclusions contained in the Articles of Association of the Company which exonerate him from liability in respect of any breach of fiduciary duty on his part and preclude any claim against him in respect of such alleged liability. The relevant Articles are 131 and 132 which read as follows:

> *131. Every Director (including for the purposes of this Article any alternate Director appointed pursuant to the provisions of these Articles), Secretary, Assistant Secretary, or other officer for the time being and from time to time of the Company (but not including the Company's auditors) and the personal representatives of the same shall be indemnified and secured harmless out of the assets and funds of the Company against all actions, proceedings, costs, charges, expenses, losses, damages or liabilities incurred or sustained by him in or about the conduct of the Company's business or affairs or in the execution or discharge of his duties, powers, authorities or discretions, including without prejudice to the generality of the foregoing, any costs, expenses, losses or liabilities*

incurred by him in defending (whether successfully or otherwise) any civil proceedings concerning the Company or its affairs in any court whether in the Cayman Islands or elsewhere.

132. No such Director, alternate Director, Secretary, Assistant Secretary or other officer of the Company (but not including the Company's auditors) shall be liable (a) for the acts, receipts, neglects, defaults or omissions of any other such Director or officer or agent of the Company or (b) for any loss on account of defect of title to any property of the Company or (c) on account of the insufficiency of any security in or upon which any money of the Company shall be invested or (d) for any loss incurred through any bank, broker or other similar person or (e) for any loss occasioned by any negligence, default, breach of duty, breach of trust, error of judgement or oversight on his part or (f) for any loss, damage or misfortune whatsoever which may happen in or arise from the execution or discharge of the duties, powers authorities, or discretions of his office or in relation thereto, unless the same shall happen through his own dishonesty.

46. Mr. Gilbertson contends that these Articles exonerate him as a director and that on the plaintiff's case it cannot be said that he was not acting in or about the business of the Company at the relevant time. References was made to the decision of the Privy Council in Viscount of the Royal Court of Jersey v Barry Shelton and Another [1986] 1 WLR 985 when the Articles of a company incorporated in

Jersey, which were in very similar terms, were considered. The Judicial Committee held that the relevant Article was to be construed as exonerating a director from personal liability, even where his actions had resulted in an act *ultra vires* the company. The Article concerned concluded with the same words as Article 132 of the Company in the present case: "unless the same shall happen through his own dishonesty". Although those words do not appear to qualify Article 131, it was accepted on behalf of Mr. Gilbertson that the two Articles should be read together and that the reference to dishonesty impliedly qualified section 131 as well. However, it was submitted that the plaintiff has not pleaded dishonesty in the present case. While acknowledging that the position with respect to the plaintiff's claim against Autumn is clearly different, it was argued nonetheless that since the claim against Autumn is dependent upon the claim against Mr. Gilbertson, if there is no cause of action against Mr. Gilbertson there can be no cause of action against Autumn.

47. The interpretation and consequences of similar articles were considered in this Court by Chief Justice Smellie in Re Bristol Fund Ltd. (In Official Liquidation) and Re Beacon Hill Master Ltd. (In Official Liquidation) 2nd May 2008 (unreported). In his judgment the Chief Justice stated (page 36):

> *116. "At this stage, the only guidance I think I can possibly give is that the Liquidators should not need to provide for amounts of damages to which EYCI may become liable based on its "wilful default or wilful neglect,*

fraud or dishonesty"; as such liabilities are excluded either expressly (as in the case of the indemnity under Article 186 of BHM's Articles) or implicitly, because of the nature of what has been termed in another context the "irreducible core" of a fiduciary's obligations; that is the duty to always act in honesty and good faith (see Armitage v Nurse [1998] Ch. 241). These irreducible core obligations would remain despite the terms of any indemnity, whether given under the Audit Engagement Letters or under Article 184 of the Bristol Articles.

117. This is a longstanding principle in English companies law see In Re City Equitable Fire Insurance Co. [1925] 1 Ch. 407at 441-442 following In Re Brazilian Rubber Plantations and Estates Ltd. [1911] 1 Ch. 425, 440 (per Romer J, upheld on appeal to the Court of Appeal).

118. It is a principle which has long since been codified in English Companies legislation; and by virtue of which codification it is not possible to give so wide an indemnity as to exclude liability for fraud, dishonesty or wilful default on the part of officers who owe fiduciary obligations to companies.....

119. Liability found against EYCI, based on allegations of simple negligence may however, be covered by the indemnities. As would plainly be any

further legal costs incurred by EYCI in successfully defending against any kind of claim covered by the indemnities".

It was argued on behalf of Mr. Gilbertson that the Chief Justice's reference to Armitage v Nurse (ibid) in support of his reference to the "irreducible core" of a fiduciary's obligations which cannot be excluded by provisions in a company's Articles was wrong because Armitage v Nurse held that all acts or omissions of the director could be indemnified or exonerated by appropriate wording in the articles, save for dishonest acts or omissions, although that would seem somewhat inconsistent with such core duties being "irreducible". In fact in Armitage v Nurse Lord Millett said:

"The nature of equitable fraud may be collected from the speech of Viscount Haldane LC in Nocton v Lord Ashburton [1914] AC 932, 953 and Snell's Equity, 29th ed. [1990], pp 550-551. It covers breach of fiduciary duty, undue influence, abuse of confidence, unconscionable bargains and frauds on powers. With the sole exception of the last, which is a technical doctrine in which the word "fraud" merely connotes excess of vires, it involves some dealing by the fiduciary with his principal and the risk that the fiduciary may have exploited his position to his own advantage. In Earl of Aylesford v Morris (1873) LR 8 Ch. App 484, 490-491 Lord Selborne LC said: "fraud does not here mean deceit or circumvention; it means an unconscious use of the power arising out of these circumstances and conditions;……"

A trustee exemption clause such as clause 15 of the settlement does not purport to exclude the liability of the fiduciary in such cases. Suppose, for example, that one of the respondents had purchased Paula's land at a proper price from his fellow trustees. The sale would be liable to be set aside. Clause 15 would not prevent this. This is not because the purchasing trustee would have been guilty of equitable fraud, but because by claiming to recover the trust property (or even equitable compensation) [my emphasis], *Paula would not be suing in respect of any "loss or damage" to the trust. Her right to recover the land would not depend on proof of loss or damage. Her claim would succeed even if the sale was at an over value; the purchasing trustee could never obtain more than a defeasible title from such a transaction. But clause 15 would be effective to exempt his fellow trustees from liability for making good any loss which the sale had occasioned to the trust estate so long as they had acted in good faith and what they honestly believed was Paula's interests.*

Accordingly much of the argument before us which disputes the ability of a trustee exemption clause to exclude liability for equitable fraud or unconscionable behaviour is misplaced. But it is unnecessary to explore this further, for no such conduct is pleaded. What is pleaded is, at the very lowest culpable and probably gross negligence. So, the question reduces itself to this: can a trustee exemption clause validly exclude liability for gross negligence?".

Lord Millett then said:

"I accept the submission made on behalf of Paula that there is an irreducible core of obligations owed by the trustee to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no right enforceable against the trustees there are no trusts. But I do not accept the further submission that these core obligations include the duties of skill and care, prudence and diligence. The duty of the trustees to perform the trust honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trust, but in my opinion it is sufficient. As Mr. Hill pertinently pointed out in his able argument, a trustee who relied on the presence of a trustee exception clause to justify what he proposed to do would thereby lose its protection: he would be acting recklessly in the proper sense of the term".

It seems to me that Armitage v Nurse does not stand for the proposition that the irreducible core of obligations owed by a fiduciary, that is the duty to act honestly and in good faith, can be excluded by an exemption clause. Breach of fiduciary duty, unconscionable conduct, generally described as equitable fraud in the sense explained by Lord Millett, resulting in a claim for equitable compensation may not be excluded.

48. It was argued on behalf of the plaintiff, that the Chief Justice's analysis is correct about the irreducible core of obligations, referred to by Millett LJ in Armitage v

Nurse which are fundamental, in that case to a trust, of performing the trusts honestly and in good faith for the benefit of the beneficiaries as the minimum necessary to give substance to the trust. By analogy a director has similar irreducible core fiduciary obligations to his company. The Chief Justice clearly considered that such core irreducible fiduciary obligations could not, because of their nature, be excluded and in my respectful view that is correct. The plaintiff's claim against Mr. Gilbertson is not for damages for negligence; it is for an accounting and for equitable compensation for breaches of fiduciary duty.

49. In Armitage v Nurse Millett LJ also said (page 251):

"It is the duty of a trustee to manage the trust property and deal with it in the interests of the beneficiaries. If he acts in a way he does not honestly believe is in their interests then he is acting dishonestly. It does not matter whether he stands or thinks he stands to gain personally from his actions. A trustee who acts with the intention of benefiting persons who are not the objects of the trust is not the less dishonest because he does not intend to benefit himself".

He also said:

"It is not necessary to use the word "fraud" or "dishonesty" if the facts which make the conduct complained of fraudulent are pleaded; but, if the facts pleaded are consistent with innocence, then it is not open to the court to find fraud. As

Buckley LJ said in Belmont Finance Corporation Ltd. v Williams Furniture Ltd. [1979] Ch. 250, 268:

"An allegation of dishonesty must be pleaded clearly and with particularity. That is laid down by the rules and it is a well-recognised rule of practice. This does not import that the word "fraud" or the word "dishonesty" must be necessarily used....The facts alleged may sufficiently demonstrate that dishonesty is allegedly involved, but where the facts are complicated this may not be so clear, and in such a case it is incumbent upon the pleader to make it clear when dishonesty is alleged.....".

Having regard to the nature of their claim in the present case it does not seem to me necessary for the plaintiffs pleading to specifically use the words dishonest or dishonestly in the context of what is alleged against Mr. Gilbertson as a director of the Company. In my view it is quite clear that the acts of Mr. Gilbertson which are alleged are, if established, self evidently dishonest and that it is not necessary for the plaintiff to specifically use the words dishonest or dishonesty in the circumstances. It is implicit in what is pleaded. Since a director's own dishonesty is expressly excluded from the provisions of Article 132 of the Company's Articles of Association and by implication from Article 131, if the plaintiff's case against Mr. Gilbertson is established it does not seem to me that Mr. Gilbertson would be indemnified or exonerated pursuant to those Articles. I should also mention that it was also argued on behalf of the plaintiff that even if

the relevant articles did apply to Mr. Gilbertson in the circumstances they would only operate to prevent recovery of losses in the form of compensation from Mr. Gilbertson and would not bar the plaintiff on behalf of the Company from suing him as a director. Accordingly, it was contended, the relief sought against Autumn by way of declarations that it holds its shares in PEL as a constructive trustee for the Company would not be affected. It was also contended that a claim against Mr. Gilbertson for an account of profits would not be precluded by the terms of the relevant Articles. I have already expressed my view on that and on the ability to exclude claims for equitable fraud. As I have said, the Plaintiff's claim is not based on allegations of negligence by Mr. Gilbertson but claims of unconscionable conduct as a fiduciary. In all the circumstances I do not consider the arguments raised on behalf of Mr. Gilbertson with respect to the construction and effect of the relevant Articles of the Company's Articles of Association are sufficiently compelling as to justify the refusal of leave to the plaintiff to continue this action.

The multiple derivative action

50. It was also argued on behalf of Mr. Gilbertson that the relevant exception to the rule to Foss v Harbottle only arises in the context of loss or damage suffered by the company of which the plaintiff is a shareholder and on whose behalf the plaintiff seeks to bring the derivative action. In the present case the alleged loss was suffered not by the Company but by the Master Fund, whose shareholding in PEL was diluted as a result of Mr. Gilbertson's actions from 100% to a nominal

amount. Furthermore, it was submitted, the economic benefits arising as a result of the investment of the Master Fund in PEL and thus the Rights were not intended to flow to the Company as ultimate general partner. Accordingly, it was contended, there is no basis for giving leave to continue the derivative action on behalf of the Company since the Company suffered no loss.

51. In Waddington Limited v Chan Chun Hoo Thomas (ibid) in the Court of Final Appeal of Hong Kong in September 2008 the plaintiff shareholder sought to impugn three transactions all of which were carried out by wholly owned sub-subsidiary companies and the alleged losses were not incurred by the ultimate holding company of which the plaintiff was a minority shareholder and on whose behalf the plaintiff had purported to bring the derivative proceedings. It appears that the appellant/defendant, who was a director of the ultimate holding company as well as of the subsidiary company and the sub-subsidiary companies, made the same submission which was made on behalf of Mr. Gilbertson before me, as outlined above. Having indicated that Counsel in that case had not been able to discover any reasoned decision of a higher court in any common law jurisdiction, outside the United States, determining this question, Lord Millett said that the court would decide it as a matter of principle. He said that such an action, known as a multiple derivative action, has been entertained in England in various cases but in none of them had the plaintiff's right to bring such an action beenchallenged. He pointed out that Wallersteiner v Moir (No. 2) (ibid) and Airey v Cordell (ibid) were themselves such cases in which the plaintiff's right to

maintain the action on behalf of a subsidiary of the company in which he was a shareholder was not contested or considered. No point was taken in those cases that the plaintiff was not a shareholder of the company in which the cause of action was said to be vested. Lord Millett concluded that the question whether the action may be brought by a member of the company's parent or ultimate holding company is one of locus standi and he went on to say:

"On a question of standing, the court must ask itself whether the plaintiff has a legitimate interest in the relief claimed sufficient to justify him in bringing proceedings to obtain it. The answer in the case of a person wishing to bring a multiple derivative action is plainly "yes". Any depletion of a subsidiary's assets causes indirect loss to its parent company and its shareholders. In either case the loss is merely reflective loss mirroring the loss directly sustained by the subsidiary and as such it is not recoverable by the parent company or its shareholders for the reasons stated in Johnson v Gore Wood ([2002] 2 AC 1). *But this is a matter of legal policy. It is not because the law does not recognize the loss as a real loss; it is because if creditors are not to be prejudiced the loss must be recouped by the subsidiary and not recovered by its shareholders. It is impossible to understand how a person who has sustained a real albeit reflective loss which is legally recoverable only by a subsidiary can be said to have no legitimate or sufficient interest to bring proceedings on behalf of the subsidiary.*

This is not to allow economic interests to prevail over legal rights. The reflective loss which a shareholder suffers if the assets of his company are depleted is recognised by the law even if it is not directly recoverable by him. In the same way the reflective loss which a shareholder suffers if the assets of his company's subsidiary are depleted is recognised loss even if it is not directly recoverable by him. The very same reasons which justify the single derivative action also justify the multiple derivative action. To put the same point another way, if wrongdoers must not be allowed to defraud a parent company with impunity, they must not be allowed to defraud its subsidiary with impunity.

After considering some other arguments of the appellant/defendant Lord Millett went on:

The last objection must also be rejected. Australia, New Zealand, Canada and Singapore have all introduced legislation to require the plaintiff to obtain the leave of the court before instituting or continuing derivative actions, and have taken the opportunity to permit multiple derivative actions where the cause of action is vested in a "related" or "affiliated" company of the company of which the plaintiff is a member. The various statutes have different threshold tests, different approaches to deciding whether the proposed action is in the interests of the company, and different procedures. But it is noticeable that in prescribing such requirements none of these statutes draws any distinction between the single derivative action and the multiple derivative action; and in truth there is no

conceivable reason why the procedural and other requirements of the two kinds of action should differ".

52. In my opinion Lord Millett's analysis and conclusion also represents the law in this country and I can see no reason why, in appropriate circumstances, a multiple derivative action should not be permitted. In the present case the Company is the general partner of and therefore controls the exempted limited partnership, GPLP. GPLP is itself the general partner and therefore controls the Master Fund. The Master Fund is, in my view, no different from a sub-subsidiary of the Company for these purposes. On the plaintiff's case the Master Fund has sustained significant loss as a result of the dilution of its 100% shareholding in PEL, procured by Mr. Gilbertson without the knowledge, still less the consent, of the Master Fund or GPLP or the Company. In the circumstances a multiple derivative action on behalf of the Company in respect of Mr. Gilbertson's actions is not, in my judgment, objectionable.

Reflective loss

53. This leaves the question of loss. In the present case, as I have just explained, the loss of the economic benefit of marketing, exploiting and managing the Rights was sustained by the Master Fund and not directly by the Company, although the Company ultimately controls the Master Fund. In Waddington v Chan Chun Hoo Thomas (ibid) the plaintiff, if multiple derivative actions were not maintainable in Hong Kong, wished to bring a single derivative action on behalf of the holding

company to recover the losses which it conceded were merely reflective of the losses allegedly suffered by its sub-subsidiaries and therefore prima facie not recoverable by the holding company. Lord Millett referred to his own judgment in Johnson v Gore Wood (ibid) where he said:

"If the shareholder is allowed to recover in respect of such loss (reflective loss), *then either there will be double recovery at the expense of the defendant or the shareholder will recover at the expense of the company and its creditors or other shareholders. Neither course can be permitted. This is a matter of principle; there is no discretion involved. Justice to the defendant requires the exclusion of one claim or the other; protection of the interests of the company's creditors requires that it is the company which is allowed to recover to the exclusion of the shareholder".*

He concluded in the Waddington case by allowing the proceedings to continue as a multiple derivative action brought by the plaintiff shareholder of the holding company on behalf of the sub-subsidiary companies but not as a derivative action on behalf of the holding company to recover damages for reflective loss. By analogy, in the present case the plaintiff as shareholder of the Company would be permitted to bring a multiple derivative action as shareholder of the Company on behalf of the Master Fund but not a derivative action on behalf of the Company to recover compensation (or an accounting) for loss reflective of the loss sustained by the Master Fund. In fact, in its statement of claim, as I have already explained

above, the plaintiff expressly pleads that the Company, including in its capacity as general partner of GPLP and, in turn, the Master Fund is entitled to the relief which it seeks against Mr. Gilbertson and Autumn. All of the relief sought, whether for declarations, accounting, equitable compensation, payment and interest is specifically on behalf of the Company and/or GPLP and/or the Master Fund. In my view this makes it sufficiently clear that this is not a derivative action on behalf of the Company to recover compensation for reflective loss. In fact it was argued on behalf of the plaintiff that the Company did suffer some direct loss itself as a result of Mr. Gilbertson's actions because it was intended that the Company should exercise ultimate control over investments of the Master Fund, in this case through the Master Fund's intended 100% ownership of PEL, of PEL's commercial interests in the Rights. That is, however, not clearly specifically pleaded as a direct loss to the Company in the present statement of claim.

The Letter Agreement

54. Finally, it was also submitted that another reason why leave should not be granted to the plaintiff to continue the action is because the Letter Agreement is null and void ab initio. Paragraph 8.2 of the Letter Agreement provides that the Letter and its terms:

> "*Automatically terminate and become null and void if the Investment Fund and the Fund Management Vehicle are not established and operating in a way*

reasonably satisfactory to each of the Partners within 16 months of the last signature to this letter. In this regard, the Partners, using their best endeavours, agree to do (and procure the doing by other parties of) all acts necessary, and to refrain (and procure that other parties will refrain) from any acts hindering the successful establishment and operation of the Investment Fund and Fund Management Vehicle".

It is apparently common ground that clause 8.2 has been implemented. In the letter dated 25th May 2007 from Renova Holding to Mr. Gilbertson, to which I have already referred, Renova Holding said:

"This 16 month period has now ended and it is clear that the Pallinghurst Structure (which comprises the Investment Fund and the Fund Management Vehicle) is not "established and operating in a way reasonably satisfactory" to either or both of us".

The letter then set out Renova Holdings' reasons for that view and went on:

"In light of the above, it is clear that we both consider that the Pallinghurst Structure is not operating in a way reasonably satisfactory to us.

With effect from midnight yesterday, the Letter Agreement and its terms have therefore ceased to have any legal effect ab initio in accordance with the terms of clause 8.2 as expressly agreed by the parties.

Mr. Gilbertson argued that since the Letter of Agreement is to be treated as having no legal effect ab initio, it follows that either party was free to pursue for their personal benefit any investment opportunities which they had identified and that Mr. Gilbertson was accordingly entitled to pursue the investment in the Rights himself for his own personal benefit.

55. I do not accept this argument. Mr. Gilbertson's fiduciary duties to act honestly and in good faith in his capacity as a director of the Company do not derive from the Letter Agreement but are a matter of law. While Mr. Gilbertson may have had other more specific duties pursuant to the Letter Agreement, they were not his sole duties and those duties are not, in my view, affected whether or not the Letter Agreement is properly considered to be null and void ab initio. The duties of Mr. Gilbertson pleaded by the plaintiff in its statement of claim are not, or are mostly not, dependant upon the Letter Agreement.

Conclusion

56. In conclusion, having regard to all of the affidavit evidence and the helpful arguments and submissions of leading Counsel, I have reached the view that the plaintiff should have leave pursuant to GCR O.15, r.12(A) (2) to continue this

action. I am satisfied that the plaintiff on behalf of the Company has a prima facie case and that this is not an action which should be dismissed at this stage. As I have already indicated, I do not consider that adjourning the application or the action to enable a meeting of the shareholders of the Company to consider whether the Company should or should not bring the action would serve any purpose. I have also considered whether leave to continue the action up to only a certain point, such as discovery, would be appropriate but in my view, having regard to the nature of the issues in the case, it would not. There is no application by the plaintiff for indemnity of its costs of the action from the Company and counsel for the plaintiff expressly states that there is no intention to make such an application. I therefore see little point in granting leave to the plaintiff to continue the action only up to a certain point. If the parties cannot reach a compromise it will have to go to trial. Accordingly I direct that Mr. Gilbertson and Autumn shall file and serve their defence or defences within 21 days of this date and that the plaintiff shall file and serve any reply or replies within a further 21 days. On the close of pleadings the plaintiff shall file and serve a summons for directions seeking further directions, agreed if possible, for the further progress of the proceedings to trial.

57. In the circumstances I consider it appropriate that the costs of and incidental to the hearing before me should be costs in the cause, such costs to include the cost of one leading counsel for each of the plaintiff on the one hand and Mr. Gilbertson and Autumn on the other hand.

Dated 14th April 2009

The Hon. Mr. Justice Angus Foster
Judge of the Grand Court (Acting)