THE HIGH COURT

COMMERCIAL

[2012 No. 5 IA.]

IN THE MATTER OF AN INTENDED DERIVATIVE ACTION

BETWEEN

SEÁN CONNOLLY

APPLICANT

AND

SESKIN PROPERTIES LIMITED, MICHAEL WHELAN AND MICHAEL J. WHELAN

RESPONDENTS

JUDGMENT of Mr. Justice Kelly delivered on the 27th day of July, 2012

Introduction

1. If a company suffers a legal wrong it is the company itself which must sue in respect of damage resulting from it. That is the rule in *Foss v. Harbottle* [1843] 2 Hare 416.

2. The reason for the rule is that, in law, a company is a legal person with its own corporate identity. That identity is separate and distinct from its directors and shareholders.

3. As is the case with most legal rules, the rule in *Foss v. Harbottle* admits of exceptions. Were it not to do so, it could work injustice. For example, if a company is defrauded by directors who control it and who hold a majority of the shares, they will not authorise proceedings to be taken by the company against themselves. So the rule in *Foss v. Harbottle* may be abrogated in such circumstances. In an appropriate case, the law permits of a derivative action being taken on behalf of the company with leave of the court. The applicant contends that this is such a case.

4. The procedure to be followed in seeking leave to commence a derivative action is now governed by an amendment to the Rules of the Superior Courts which came into operation on 16th November, 2010. (S.I. 503/2010).

5. This amendment to O. 15 of the Rules of the Superior Courts sets out in some detail the steps which must be taken in order to secure leave to commence a derivative action.

6. It is such an application that falls to be dealt with in this judgment. The parties have complied with S.I. 503/2010.

Background

7. The applicant is a shareholder and director in the first named respondent (Seskin). Seskin was incorporated in June 1998. Its shareholders at the time of incorporation were the applicant as to 49% and the second named respondent (Mr. Whelan) as to the balance. Since incorporation, a company called Moritz Property Investment Company or Moritz Holdings (Moritz) acquired Mr. Whelan's shares in Seskin. There is disagreement as to which Moritz entity is involved but nothing turns on that. The applicant has maintained his 49%.

8. The directors of Seskin are the applicant, Mr. Whelan and the third named respondent (Mr. Whelan Jr.).

9. Moritz is a company owned and controlled by Mr. Whelan and Mr. Whelan Jr.

10. It is clear, therefore, that at all relevant times, Mr. Whelan and Mr. Whelan Jr. have either directly or indirectly been in control of Seskin. The applicant is in a minority at both board and shareholder level of that company.

11. Mr. Whelan and Mr. Whelan Jr. are also shareholders and directors of a company called Maplewood Developments (Maplewood). That is the proposed first defendant in the intended derivative action. The second and third defendants in the intended derivative action are Messrs. Whelan and Whelan Jr.

The Claim

12. The applicant seeks leave to commence a derivative action in the name of Seskin against Maplewood and the two Whelans. The claim is for the sum of €5,329,920. It is alleged that this is the balance due and owing on an account pursuant to an agreement dated 14th June, 2007 (the agreement). That agreement was made between Maplewood and Seskin. Under it, Seskin agreed to carry out the construction and completion of 82 residential units on a site at Ballynakelly, Newcastle, Co. Dublin. It is the applicant's belief that that sum is due, particularly having regard to the provisions of clause 4 of the agreement.

Clause 4

13. Clause 4 identified the contract price for the carrying out of the works by the contractor (Seskin) in the sum of €15,744,000 plus VAT at the applicable rate. Maplewood agreed to pay that in the manner set out as follows in the remainder of clause 4:-

> *"4.1.1 On the completion of each sale by the developer of each completed residential unit the developer shall pay to the contractor the sum of €192,000 (plus VAT at the applicable rate).*
>
> *4.1.2 The contract price shall be increased in the event that the actual sales prices of the residential units are higher*

than the projected sales prices of the residential units to a sum to be agreed between the developer and the contractor based upon any difference between the projected sales prices of the residential units and the actual sales prices of the residential units and the payment of any such increase shall be made at such time or times as agreed between the developer and the contractor. The projected sales prices of the residential units are referred to in the schedule to this agreement."

14. Seskin completed the works provided for in the contract and issued invoices in respect of them. Between February 2008 and November 2011, Seskin issued invoices totalling €14,342,400. During that period, Maplewood paid Seskin €9,012,408. The balance is alleged to be due to Seskin by Maplewood.

Applicant's Case

15. The applicant believes that Mr. Whelan and Mr. Whelan Jr. in their capacity as controlling directors of Seskin, allowed a substantial debt to accumulate with Maplewood in circumstances where they knew or ought to have known that Maplewood would not be in a position to pay the debt. He alleges that they have an intention not to pursue Maplewood for the recovery of the monies. He contends that the accrual of that debt and the refusal by Mr. Whelan and Mr. Whelan Jr. to institute proceedings in their capacity as directors of Seskin is not in the interests of that company. Rather, it is in the interests of Maplewood which is owned and controlled by them. As already mentioned, the applicant, in his proposed proceedings, does not limit his claim to one against Maplewood. He seeks to sue Mr. Whelan and Mr. Whelan Jr. The basis of the claim against them is that in the event of Maplewood being unable to satisfy any judgment which may be obtained against it, they should be liable for the judgment sum by reference to their breach of duty towards Seskin. It is alleged that they owe obligations including fiduciary ones to Seskin as its directors. They failed to live up to them, it is said, by not acting *bona fide* in Seskin's best interests by allowing the debt in question to mount up when they knew Maplewood might not be in a position to pay it. It is in these circumstances that this application for leave to commence the derivative action is brought.

16. The applicant also alleged in a supplemental affidavit that Mr. Whelan and Mr. Whelan Jr had personally guaranteed the borrowings of Maplewood and thus had *"used the money owed to Seskin to shore up the financial position of Maplewood in their own personal interest"*. The existence of such guarantees was denied in categoric terms. Ultimately, it was accepted by the applicant that there are no such guarantees.

17. The applicant accepts that he did not raise this issue before June 2011. He said that that was because his relationship with Mr. Whelan dated back 30 years and was both a personal and business one. During that time, he never had any problems with Mr. Whelan and his relationship was founded on integrity, trust and honesty.

18. On 16th June, 2011, the applicant's then solicitor wrote to Mr. Whelan and Mr. Whelan Jr. The letter drew attention to the provisions of clause 4.1 of the agreement and complained that Messrs. Whelan were not prepared to demand and pursue Maplewood for these monies.

19. The letter went on to say that the applicant could seek to call a meeting of the members of Seskin but, as the majority shareholder was Moritz, control of its board and its membership was held, in effect, by the Whelans. The letter then called upon them to arrange for payment of the monies due by Maplewood to Seskin forthwith.

20. On 1st November, 2011, a meeting of the board of directors of Seskin was held. It was attended by the applicant and Mr. Whelan and Mr. Whelan Jr. The applicant prepared a minute of that meeting which was exhibited in his grounding affidavit. Insofar as it is relevant, it records:-

> *"Mr. Michael Whelan Snr. disputed the amount of money owed and said 'that Maplewood Developments Limited could do nothing about it anyway as it had no money'. He also disputed the terms of the contract in that it did not include a provision for a downturn in the economy and the prices realised on sales of the houses.*
>
> *Séan Connolly stated that he had no alternative but to institute proceedings to recover this money."*

21. That meeting was followed by a further solicitor's letter sent by the applicant which pointed out that that applicant had no alternative but to institute the current proceedings.

22. On 19th January, 2012, Ulster Bank appointed a receiver over Maplewood's assets. Whilst the company was not placed into receivership, the applicant accepts that the recovery of the sums allegedly due from Maplewood appears to have been prejudiced by this step.

The Response

23. The Whelans are of the view that the agreement did not reflect the true bargain between Maplewood and Seskin. They were not involved in the negotiation of the agreement. That was looked after by Mr. John Barrett who was formerly a director of Seskin and Maplewood. Neither was the applicant involved. He describes himself as a stranger to the instructions given by Mr. Barrett in the drafting of the agreement.

24. When the applicant raised the prospect of a claim against Maplewood with Mr. Whelan and Mr. Whelan Jr., they asked Mr. Barrett about the matter. He has sworn an affidavit in these proceedings.

25. Mr. Barrett is a chartered accountant. He qualified in 1983 and was a Partner in a private practice from 1991 to 2001. He joined Moritz and its principal subsidiaries as group financial director in 2001. He held that post until 2011. During those years, he was responsible for the preparation of the financial accounts for the majority of the companies within the group. Part of his duties was to produce full consolidated accounts for the group whose main holding was Mortiz.

26. At the time of the negotiation of the agreement, he was a director of Seskin. He resigned from that position on 30th November, 2009.

27. He says that at the time of the negotiation of the agreement in June 2007, it was intended that Maplewood would provide the land and Seskin would carry out the development in a way which had been done on a number of previous occasions. To avoid additional stamp duty, the lands were not transferred to Seskin and a building agreement was drawn up. This was done on the advice of KPMG chartered accountants.

28. Mr. Barrett was directly involved in the drawing up of the agreement. He says that it is not clear to him how the final draft ended

up as it did. He says that it was never the intention that Seskin would reap the benefits if the land value went up but would not take a reduction in the amount paid to it if the price *per* house went down. It was, he said, always the intention that there would be a reconciliation at the end of the contract and that any profit or loss would be attributed to Seskin. He further says that the audited accounts of Seskin were completed and signed by the auditors, the applicant and the Whelans. No adjustment was reflected in the accounts for any *"upward"* only adjustment to the sales figures.

29. Mr. Barrett says that the agreement was entered into only because KPMG had advised it in relation to the stamp duty issues. It was never intended to dramatically change the relationship between Seskin and Maplewood. That was always to the effect that Maplewood put up the land and Seskin built the houses at its own risk. The agreement, he says, does not accurately reflect what was envisaged.

30. When he was asked to investigate the matter by the Whelans at the time when the applicant first raised the issue, he went to KPMG and BCM Hanby Wallace in order to go through the files of those two firms. He found five memoranda which specifically stated that the risk was to be with Seskin. There were earlier drafts of the agreement which set out that Seskin would receive the uplift if there was an increase in the sales value of any house, and would also absorb the decrease if there was a reduction in the sale value of a house. This would have reflected what all parties anticipated would happen, he said. He acknowledges, however, that that is not what is in the final version of clause 4.1.2 which is now relied upon by the applicant. He says that it is not clear to him how it came about that no provision was made for reconciliation, but he considers it to be a mistake of BCM Hanby Wallace in drafting the agreement. In his affidavit, Mr. Barrett exhibited a number of documents emanating from KPMG and BCM Hanby Wallace. In particular, reference is made to an attendance at a meeting which took place on 22nd November, 2006, at that firm.

31. His affidavit also sets out the entire background to the agreement. It is instructive to consider this in some detail.

Background to the Agreement
32. In 1998, the applicant and Mr. Whelan agreed that Seskin would be set up. It would build houses for Maplewood under a licence agreement. A number of developments took place and a large number of houses were built over the years. There was no formal written agreement in writing between the companies. The arrangement was that Seskin and the applicant would be responsible in full for each of the developments and the applicant was its managing director. He was also responsible for keeping its books of account. The lands and the sites were the responsibility of Moritz. It had to deliver the sites as agreed to Seskin.

33. Mr. Barrett avers:-

> *"In all previous developments between the group and Seskin Properties, Sean Connolly was fully responsible for all costs and expenses. In effect, Mr. Connolly insisted that he wanted to have full responsibility for all aspects of the developments to include the sales risk. At all times, Seskin properties was to benefit from any increase in sales prices, but would also suffer the cost if a house was sold below the original estimate."*

34. Mr. Barrett says that at the commencement of the development in Ballynakelly, certain houses were sold at prices greater than those contained in the agreement. These houses were sold between 6th December, 2007, and 17th October, 2008. His affidavit lists out those houses and they show a difference between the sales price and the contract price of some €542,029. He says that at no time did he, as the financial director, get a request to take account, revise or pay the additional sum of €542,029, a sum greater than the price agreed, as it was known at the time that other houses were being sold at prices less than anticipated. The adjustment, he said, would be taken into account at a later stage and closer to the end of the development.

35. Mr. Barrett believed that the applicant was in control of the day-to-day operation of Seskin. The majority shareholders did not interfere with the operations of the company. He cites as an example of this that when the applicant suggested that the company invest in a site in Thailand, that was discussed in some length at the Moritz board, but as the applicant was the managing director of Seskin, the board accepted his decision on investing €1.5m approximately in acquiring that Thai site.

36. Mr. Barrett said that the price agreed for the supply of all sites to Seskin from the Moritz holding companies was the original cost price of the lands to the group with a small adjustment to take account of interest which would accrue over the construction period. At no time was it ever the intention nor was it ever discussed that any sales price risk would rest with Maplewood. The deal was always the same, namely, that Seskin would make more profits if the sales price went up and would suffer losses if prices dropped.

37. In September 2006, he attended a meeting with KPMG to discuss the tax position and the implementation of a scheme that would be 100% tax compliant but would not put at risk stamp duty or any increase in corporation tax rates. He exhibits the briefing note of that meeting prepared by Mr. Jim Cleary of KPMG. That note includes the following:-

> *"It is key that Tenbury (Maplewood) must ultimately be seller of the houses, not Seskin. This is notwithstanding that Seskin, economically, should be entitled to the profits or losses from the development. This can be achieved through contractually (sic) arrangements and should be discussed now with Seskin Developments.*
>
> *The payments under the construction contract would be linked to the overall performance of the development, such that the economic plusses and minuses of the development are ultimately parked with Seskin."*

38. He also quotes from an email sent from a tax manager in KPMG which was sent after a briefing where it is stated:-

> *"The payments under the construction contract will be linked to the overall performance of the development and any increase or decrease in the anticipated profit will rest with Seskin Limited."*

39. In November 2006, he advised KPMG about the sale of the sites and quotes from a file note prepared by KPMG which contains the following:-

> *"Jim Cleary said that the building contract should include a price variation clause based on performance and we agreed that we could look at that. He said that essentially if sales proceeds were more than €35m, more money went to Seskin. If sales profits were less than €35m, less money went to Seskin based upon current figures."*

40. Following that meeting, BCM Hanby Wallace produced various drafts of the agreement which referred to changes to the initial draft. Mr. Barrett said it is clear to him that that firm made an error in the final agreement sent out for signing between the parties. He quotes from a file memo prepared by a member of that firm which he says shows a misunderstanding of where the risk was to fall in the event of a price drop. The memorandum reads:-

> *"He (John Barrett) further confirmed that the price to be paid would only increase in the event that projected sales prices increased and in the event that sales prices decreased that the price to be paid would not decrease. He said that this was Seskin's risk.*
>
> *John confirmed the prices were net of VAT and that he would deal with the treatment of VAT directly with Seskin. In the event that individual items would increase or decrease, then John said that he would deal with this as a management expense between the two companies . . ."*

41. Mr. Barrett is quite specific. He says that these were not his instructions to BCM Hanby Wallace. They would have been out of line with anything which he envisaged. He would have said that it was *"Seskin's risk"*. He said that is a phrase which he would have used. He did not instruct that firm to do that which would specifically remove that risk.

42. Mr. Barrett was not aware of these attendance notes until he sought the file in 2011. He has since told the solicitor in BCM Hanby Wallace that he was wrong and misunderstood the instructions. That solicitor does not accept that.

43. He quotes from a further file memorandum prepared by the same solicitor which contains the following:-

> *"I also confirmed with both John and Sean that clause 4.1.2 should not provide for a decrease in the contract price and they both confirmed that the contract price was to be reviewed on an upwards only basis.*
>
> *John also said that the reality was that he and Sean would not be carrying out a balancing exercise on the sale of each apartment and that they would probably do this at the end of the sales or during the course of it. John said that he would like some reference to be made to this and I agreed that I would add some amending wording to generally cover the position."*

44. Mr. Barrett said that the first paragraph of that memorandum is totally incorrect and arises out of complete misunderstanding by the solicitor. The second portion is accurate but he is not aware that any wording was changed. The contract was sent out and signed in the form that was incorrect on the following day. He confirms that he, as a director of both Seskin and Maplewood, signed the contract on 14th June, 2007.

45. Finally, Mr. Barrett points out that during 2011, he met on a number of occasions with the current directors of Seskin, including the applicant. He exhibits memoranda which he prepared in respect of those meetings. He says that at none of the meetings did the applicant directly deny everyone else's understanding of the actual agreement reached between Seskin and Maplewood. However, he continued to rely on the actual wording of the contract.

Mr. Whelan's Evidence

46. Mr. Whelan says that the majority of the directors of Seskin do not regard the agreement as accurately embodying the actual agreement between Seskin and Maplewood. Thus, if Maplewood were sued, it would counterclaim for rectification of that agreement. The contention is that it would have a good case for rectification. Mr. Barrett's affidavit sets out the detail which would be relied upon to substantiate such a claim.

47. Mr. Whelan says that even if Seskin was owed money by Maplewood, Maplewood would not be in a position to discharge the amount claimed. It has been in financial difficulties since 2009. It is a property development company and, like many others, is in severe trading difficulties. It continues to trade, largely in order to work out the best return for its major secured creditors, namely, NAMA and Ulster Bank. If Seskin pursues the amounts due, it will be an unsecured creditor in the liquidation of Maplewood and would secure no return.

48. Mr. Whelan does not accept that either he or Mr. Whelan Jr. have benefited or been in breach of fiduciary duty to Seskin. He says that they formed the legitimate view that the agreement did not accurately reflect the actual arrangement negotiated between the companies. Maplewood is trading for the benefit of its creditors alone rather than its directors and shareholders. Seskin is solvent with assets of €1.5 to €1.8 million. He believes it has liabilities to trade creditors is about €200,000 and there is a loan of approximately €1m with Ulster Bank. That loan is fully secured on land owned by a separate company within the Moritz Group with no association to Seskin.

49. It is Mr. Whelan's belief that if a derivative action were commenced, the applicant would be entitled to an indemnity from Seskin in respect of his costs. Thus, whether he succeeded or not against Maplewood, he believes Seskin would be destroyed. Seskin has an asset, namely, lands in Thailand worth in the region of €1.5 to €1.8 million. At the conclusion of the hearing, the applicant indicated that if granted leave, he would not seek the indemnity from Seskin but would fund the litigation himself, should the court think this necessary.

50. Mr. Whelan dealt with the alleged mistake in the agreement as follows. He said the claim first came to his attention when the applicant raised the issue directly in March 2011. He spoke to Mr. Barrett who made it clear to him that there was an error in the contract. Mr. Barrett pointed out how the supporting and drafting documentation reflected the intended meaning of the agreement and not that which was executed. At a meeting which held with the applicant and his advisors on 25th March, 2011, Mr. Whelan went through the background to the matter in some detail and explained the rationale for the contract as he understood it. It was in accordance with all previous developments which had been undertaken by Seskin. He says that the applicant at no time during that meeting disputed this basic understanding. The affidavit goes into various other details concerning attempts made to try and meet with the applicant, but ultimately the matter has reached the stage that it now has.

51. Finally, Mr. Whelan said that neither he nor his son nor Moritz benefit in any way from proceedings not being instituted by Seskin against Maplewood. He does not believe that such proceedings would succeed or are appropriate. He also raises an issue concerning the indemnity and the likely effect which that would have on Seskin's asset in Thailand. This feature of the case has much diminished as a result of the applicant's approach to the indemnity as already noted.

Derivative Action

52. At the outset of this judgment, I stated the rule in *Foss v. Harbottle*. As I pointed out, that rule admits of exceptions so as to ensure that the application of that legal rule does not bring about an injustice.

53. The general principles governing actions in respect of wrongs done to a company or irregularities in the conduct of its affairs were set out with clarity by Peter Gibson L.J. in delivering the leading judgment in the Court of Appeal in *Barrett v. Duckett* [1995] 1 BCLC 243. He said:-

"1. The proper plaintiff is prima facie the company.

2. Where the wrong or irregularity might be made binding on the company by a simple majority of its members, no individual shareholder is allowed to maintain an action in respect of that matter.

3. There are, however, recognised exceptions, one of which is where the wrongdoer has control which is or would be exercised to prevent a proper action being brought against the wrongdoer: in such a case, the shareholder may bring a derivative action (his rights being derived from the company) on behalf of the company.

4. Where a challenge is made to the right claimed by a shareholder to bring a derivative action on behalf of the company, it is the duty of the court to decide as a preliminary issue the question whether or not the plaintiff should be allowed to sue in that capacity.

5. In taking that decision, it is not enough for the court to say that there is no plain and obvious case for striking out; it is for the shareholder to establish to the satisfaction of the court that he should be allowed to sue on behalf of the company.

6. The shareholder will be allowed to sue on behalf of the company if he is bringing the action bona fide for the benefit of the company for wrongs to the company for which no other remedy is available. Conversely, if the action is brought for an ulterior purpose or if another adequate remedy is available, the court will not allow the derivative action to proceed."

Derivative Action: The Test

54. In *Prudential Assurance Company Limited v. Newman Industries Limited (No 2.)*[1982] 1 Ch. 204, the Court of Appeal in England held that before a minority shareholder should be permitted to bring a derivative action on behalf of the company, he *"ought at least 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"*. In a moment, I will consider the exceptions to the rule in *Foss and Harbottle*. Before doing so, however, I ought to point out that in this jurisdiction, Irvine J., in *Fanning v. Murtagh* [2009] 1 I.R. 551, held that the standard of proof required of an intended plaintiff is that he must establish *"a realistic prospect of success"*. It is accepted by the applicant that that is the more appropriate standard to apply rather than the establishment of a mere *prima facie* case as identified in the *Prudential* case *supra*.

Exceptions to the Rule in *Foss v. Harbottle*

55. These were dealt with by Irvine J. in *Fanning v. Murtagh* where she said:-

"There are four recognised exceptions to the rule in Foss v. Harbottle, which may permit an individual shareholder as a minority to sue on behalf of the other shareholders. These exceptions, briefly stated, comprise the following categories of wrongdoing namely:-

(a) an act which is illegal or ultra vires to (sic) the company;

(b) an irregularity in the passing of a resolution which requires a qualified majority;

(c) an act purporting to abridge or abolish the individual rights of a member;

(d) an act which constitutes a fraud against the minority and the wrongdoers are themselves in control of the company."

56. The applicant invites me to accept a fifth exception relying in part upon the decision of the Supreme Court of Western Australia and a decision of Finlay Geoghegan J. in *Glynn v. Owen* [2007] IEHC 328.

57. The Australian case is *Biala Pty Limited v. Mallina Holdings Limited* [1993] ACSR 785. In that case, the court (Ipp J.) considered the question of whether or not a fifth exception to the rule in *Foss and Harbottle* exists. The judge pointed out that it is a matter of controversy. He quoted from *Foss v. Harbottle* itself where Sir James Wigram V.C. made remarks indicative of a view that there should be a general power of interference by the courts where justice demands that such a power be exercised. The quotation from Wigram V.C. reads:-

"If a case should arise of injury to a corporation by some of its members, for which no adequate remedy remained, except that of a suit by individual corporators in their private characters, and asking in such character the protection of those rights to which in their corporate character they were entitled, I cannot but think that the principles so forcibly laid down by Lord Cottenham in Walworth v. Holt 4 MYL and CR 365 (see also 17 VES 320 per Lord Eldon) and other cases would apply, and the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporations are required to sue."

Ipp J. then conducted a review of a series of cases before concluding:

"Equity is concerned with substance and not form, and it seems to me to be contrary to principle to require wronged minority shareholders to bring themselves within the boundaries of the well recognised exceptions and to deny jurisdiction to a court of equity even where an unjust or unconscionable result may otherwise ensue . . . accordingly, I uphold the argument of the plaintiffs that the court may allow a derivative action by shareholders in circumstances where the justice of the case so requires."

57. This line of argument was considered by Finlay Geoghegan J. in *Glynn v. Owen* [2007] 1 IEHC 328. This is what she said:

"The plaintiffs, in the alternative, seek to pursue the derivative claims as an exception to the rule in Foss v. Harbottle 'in the interests of justice'. In Crindle Investments v. Wymes Keane J., at p. 592, refers to this as 'the less solidly based fifth exception which suggests that the rule may be relaxed where the interests of justice so require'. On the facts of that appeal, it was not necessary for the Supreme Court to decide whether such an exception exists.

Writing extra-judicially Keane C.J. at paragraph 26.20 of his Company Law, 4th Ed.,(Tottel, 2007), takes a more positive view and states:

'While the view was advanced in earlier editions of this book that the Irish courts might be reluctant to extend the exceptions to the rule, that is probably to err on the side of caution. While it is true that the wide import of the term 'fraud' enables most deserving cases to avail of the third exception where the other two are not available, there is probably no good reason why the courts should not carve out further exceptions if justice so requires. Not only should the judicial comments in support of that view already cited be borne in mind; it is also worth noting that in the two seminal cases of Foss v Harbottle itself and Edwards v Halliwell, Wigram V-C and Jenkins LJ both observed that the rule should not be applied in so rigorous a fashion in any case as to lead to injustice'.

I respectfully agree that the formulation of the rule in the earlier cases makes clear that it should not be applied in such a way as to lead to injustice. Nevertheless, the entitlement of a shareholder to pursue by way of derivative action a claim for and on behalf of a company is an exception to an 'elementary principle' as referred to above. As such, it should not be broadly or liberally applied. A very strong case would have to be made out. It would also have to be consistent with the principles underlying the rule in Foss v. Harbottle and the exceptions to it. These include the reluctance of the courts to interfere in the internal management of a company."

58. I respectfully agree with this approach.

The Present Case
59. The applicant contends that he falls within two of the exceptions to the rule in *Foss and Harbottle.* He says that the matters of which he complains constitute a fraud against the minority and the wrongdoers are themselves in control of the company. Alternatively, he contends that he comes within the so-called fifth exception and that the justice of the case demands that he permitted to commence his derivative action.

Fraud on the Minority - The Fourth Exception
60. In *Crindle Investments v. Wymes* [1998] 4 I.R. 567, Keane J. said in this context:

"To make out such a case it is not, of course, necessary to establish that there was fraudulent conduct in the criminal sense. Doubts have even been expressed as to whether fraud in any sense need to be established: thus, Templeman J., as he then was, in Daniels v. Daniels [1978] Ch. 406 at p. 413 said:-

'The authorities which deal with simple fraud on the one hand and gross negligence on the other do not cover the situation which arises where, without fraud, the directors and majority shareholders are guilty of a breach of duty which they owe to the company and that breach of duty not only harms the company but benefits the directors . . . If minority shareholders can sue if there is fraud, I see no reason why they cannot sue where the action of the majority and the directors, though without fraud, confers some benefit on those directors and majority shareholders themselves. It would seem to me quite monstrous - particularly as fraud is so hard to plead and difficult to prove - if the confines of the exception to Foss v. Harbottle (1843) 2 Hare. 461, were drawn so narrowly that directors could make a profit out of their negligence'.

In the context of the present case, it is unnecessary to say whether that interesting passage states the law too widely. Whatever be the confines of the exception, the submissions on behalf of the plaintiffs in the present case overlook one critical factor which renders the exception - and, for that matter the less securely based fifth exception - inapplicable."

61. The respondents accept that the applicant does not have to establish fraudulent conduct in the criminal sense in order to fall within this exception.

62. What constitutes fraud on a minority has been considered in many cases. It has been found to exist in different situations involving varying degrees of moral turpitude. In *Pavlides v. Jensen* [1956] Ch. 565, Danckwerts J. speaks of the observations of Lord Davey in the case of *Burland v. Earle* [1902] AC 83, as confining the cases in which a derivative action can be brought *"to those in which the acts complained of are of a fraudulent character (in which he includes appropriation by a majority in fraud of the minority of the shareholders) or beyond the powers of the company".*

63. It would, given the ever changing circumstances of modern commercial life, be unwise to attempt to identify what might or might not constitute fraud on a minority in any given case. What can be said, however, is that it usually involves some element of moral turpitude.

64. The applicant accepts that Finlay Geoghegan J. in *Glynn v. Owen* correctly identified that the onus is on an applicant to place himself within this exception to the rule in *Foss v. Harbottle*. That onus of proof will only be discharged if it is demonstrated that there was (a) a wrong done to the company; (b) that it was done at a time when the company was controlled by the alleged wrongdoers, and (c) that those wrongdoers benefited from their alleged wrongdoing.

65. I turn now to a consideration of whether or not the applicant has discharged this onus of proof.

The Pleadings
66. The pleadings in the proposed derivative action were exhibited in the applicant's grounding affidavit. They consist of a plenary summons and statement of claim. Judgment is sought against Maplewood for the sum in suit and there is also sought damages for breach of duty including breach of fiduciary duty as against the Whelans.

67. In the statement of claim, these claims are enlarged upon.

68. Insofar as Maplewood is concerned, the claim is made by reference to clause 4.1 of the agreement. In the event that Maplewood is unable to meet its obligations, a claim is propounded against the Whelans for breach of duty, including fiduciary duty to Seskin. It is alleged that the refusal by the Whelans as directors of Seskin to sue Maplewood was not in the interests of Seskin, but rather in the interests of Maplewood. It is also alleged that they allowed a substantial debt to accumulate with Maplewood over a period of time in circumstances where they knew or ought to have known that Maplewood might not be in a position to pay that debt. Thus, it is alleged that they have acted in breach of their duties as directors of Seskin by using Seskin to fund another company in which they have a controlling interest. It is alleged that they failed to exercise their powers *bona fide* and in the interests of Seskin, but rather

did so in furtherance of their own personal interests. It is in that context that they are alleged to have breached their fiduciary duties to Seskin and placed themselves in a position whereby their paramount duty to Seskin came into direct conflict with their own personal interests. This, it is said, amounted to an abuse of their position to gain personal advantage.

Prospects of Success
69. In the intended derivative proceedings, the plaintiff would have to succeed in recovering judgment for the €5,329,920 against Maplewood before any question of recovery against the Whelans would arise. That claim relies on the provisions of the agreement, and in particular, clause 4.1.2 thereof. The contention is that the agreement does not embody the true agreement which was sought to be achieved. In support of that contention, there will be evidence from Mr. Barrett. He avers that it was never the intention that Seskin would reap the benefits if the land value went up, but would not take a reduction in the amount paid to it if the price per house went down. He was the person involved in considering the advice from KPMG and giving instructions to Byrne Wallace, solicitors. Neither the applicant nor the Whelans took part in that exercise.

70. Mr. Barrett is unequivocal in what he says, *"It was never intended to dramatically change the relationship between Seskin and Maplewood which was that Maplewood put up the land and Seskin built the houses at its own risk".*

71. Mr. Barrett says the solicitors in question made a mistake and produced the agreement in the form in which it was ultimately executed. The written agreement does not reflect what was intended by him as the person who was giving instructions in relation to the whole transaction.

72. Mr. Barrett is no longer associated with either company so he can be considered to be somewhat more independent of the entire matter than either the applicant or the Whelans. Quite apart from that, however, his account of what occurred is fortified in a number of ways. First, all of the previous dealings which the companies had, occurred in a manner inconsistent with what is now provided for in the agreement. In the prior arrangements, Seskin reaped the rewards when prices went up and took the risks when prices went down. The agreement is a departure from that arrangement. The only reason for entering into the agreement was with a view to avoiding the payment of stamp duty. That device did not require any alteration to the status quo insofar as Seskin's risk was concerned. Second, Mr. Barrett has gone to both KPMG and the former solicitors and has put before the Court contemporaneous attendances and memoranda which provide support for his contention.

73. Whilst I recognise that an order for rectification is not easy to obtain, there is, in my view, strong evidence here in support of such a claim.

74. In addition, it has to be borne in mind that the building up this alleged debt is something that has been known to the applicant for a number of years. He did not raise the matter until 2011, and that delay may also play a part in the defence of any derivative proceedings against Maplewood.

75. Overall, therefore, I am of the view that the prospects of success against Maplewood in any derivative action are poor and that it has a good prospect of succeeding in its counterclaim for rectification.

76. Even if I am wrong in that conclusion, there can be no doubt but that any judgment against Maplewood is likely to be hollow. Maplewood does not have the assets to discharge any such judgment. One then has to look to the behaviour of the Whelans and make an estimate of the prospects of success of the claim against them.

77. Even if Maplewood fails to obtain its remedy of rectification, I do not believe that a court would be persuaded to find that the decision of the Whelans not to sue was in breach of duties owed to Seskin. If the counterclaim for rectification was unstateable or had a poor prospect of success or if there was little evidence to support it, then it might be argued that the decision not sue Maplewood was not a *bona fide* one. But that is not the position. I have no better opinion of the likelihood of success of the proposed action against the Whelans than I have of its success against Maplewood. On this ground alone, the application fails.

78. Lest I am wrong in the conclusions which I have come to concerning the realistic prospect of success of any derivative action, I now to turn to consider whether the applicant has placed himself within either of the exceptions of the rule in *Foss v. Harbottle* upon which he relies.

The Fourth Exception
79. As is clear from the judgment of Finlay Geoghegan J. in *Glynn v. Owen*, the applicant has to demonstrate that there was a wrong done to Seskin, that it was done at a time when that company was controlled by the Whelans and that they benefited from their alleged wrongdoing.

80. I do not believe that there is evidence before me to conclude that the decision not to pursue Maplewood constitutes a wrong on Seskin. The Whelans contend that they do not believe that there is a valid claim against that company. They have a reasonable basis for such belief and the evidence of Mr. Barrett which I have already considered is supportive of that view.

81. There is no doubt but that the Whelans were in control of Seskin when it was decided not to pursue Maplewood. However, it has to be borne in mind that the applicant was also a director of that company and appears to have played a greater part in its management than either of the Whelans. If he wished to have payments made on an up to date basis, he could have raised that question long before 2011. He raised the issue then, at a time when Maplewood did not have any funds to make the payments. It also has to be borne in mind that when the applicant did raise the issue, an investigation was carried out leading to the position as averred to by Mr. Barrett in his affidavit. I do not accept that there is cogent evidence of a wrong done to Seskin.

82. I also have difficulty in seeing how it can be said that either of the Whelans would benefit from the decision not to sue Maplewood. What fiscal benefit do they obtain by Seskin not suing Maplewood? If they had personally guaranteed the debts of Maplewood, then one could well understand that there would be a personal benefit to them by Seskin not suing it. Although the applicant alleged the existence of such personal guarantees, that was strenuously denied and ultimately at the hearing it was accepted by the applicant that there were none.

83. It also appears to me that the applicant has failed on the facts to identify any acts of a fraudulent character or of moral turpitude on the part of the Whelans. In these circumstances, I am of opinion that the applicant has not placed himself within the fourth exception to the rule in *Foss v. Harbottle*.

The Fifth Exception
84. Assuming that there is a fifth exception to the rule, it is clear that one comes within it only if the interests of justice so require.

Having regard to my previous conclusions, I do not believe that the applicant has demonstrated a case calling for such intervention by the court. I also bear in mind the observations of Finlay Geoghegan J. in *Glynn v. Owen* that this exception should not be broadly or liberally applied. A very strong case has to be made out and must be one consistent with the principles underlying the rule in *Foss v. Harbottle* and the exceptions to it. She correctly says that those principles include a reluctance on the part of the court to interfere in the internal management of a company.

85. I do not believe that the applicant has demonstrated a case for the court's intervention, still less a very strong one. Accordingly, he fails under this heading also.

Disposal
86. For the reasons which I have already outlined, this application is dismissed.