Neutral Citation Number: [2007] IEHC 328

THE HIGH COURT
COMMERCIAL

2005 No. 3238 P

BETWEEN

JAMES GLYNN AND KEVIN McCABE

PLAINTIFFS

AND
JOHNATHAN OWEN, ALLAN OWEN, STEPHEN LEYLAND,
FATSTRIPPA HOLDNGS COMPANY
AND FATSTRIPPA CORPORATION LIMITED

DEFENDANTS

Judgment of Ms. Justice Finlay Geoghegan delivered the 5th day of October, 2007.

1. The plaintiffs and the first, second and third named defendants are each a twenty per cent shareholder in and director of the fourth and fifth named defendants.

2. These proceedings commenced in September, 2005. They were admitted to the commercial list by order of 14th November, 2005. On 31st July, 2006, the Court was asked to receive and file a document entitled "proceedings settled on the following terms" but not to make it a rule of court. The intended settlement was not achieved and the matter was ultimately listed for hearing on 6th March, 2007, before Clarke J. The opening commenced but, at the request of the parties, time was given and I understand at the end of a few days the proceedings appeared capable of settlement and were again adjourned back into the commercial list. However, settlement was not achieved and the matter was re-listed for hearing before me on 27th June, 2007. The proceedings in the form they commenced before me indicated that the plaintiffs were maintaining both personal claims for alleged wrongs done by the first to third named defendants and derivative claims on behalf of the fourth and fifth named defendants by way of exception to the rule in *Foss v. Harbottle* (1843) 2 Hare 461. Counsel for the third named defendant at an early stage made an application that I determine, as preliminary matters, whether the plaintiffs are entitled to maintain these proceedings as derivative claims on behalf of the fourth and fifth defendants having regard to the rule in *Foss v. Harbottle* and as to the plaintiffs' right to maintain a personal claim alongside the intended derivative claim.

3. Counsel for the plaintiffs then informed the Court that the plaintiffs were not now proceeding with the personal claims. The only claims being pursued were the derivative claims on behalf of the fourth and fifth named defendants. This was a significant change by the plaintiffs. The existence of the personal claims alongside the derivative claim had been relied upon heavily by the former counsel for the plaintiffs in resisting an application brought in January, 2006 on behalf of the first and second named defendants (who were then legally represented) for an order *inter alia* that the plaintiffs' right to pursue a derivative claim would be heard as a preliminary issue.

4. Having heard submissions on the application for the determination as a preliminary matter the plaintiffs' entitlement to maintain the proceedings against the first to third named defendants by way of derivative claim on behalf of the fourth and fifth named defendants, I ruled on 2nd July that I should determine as a preliminary matter the following issue:

> Are the plaintiffs entitled to pursue, on behalf of the fourth and fifth named defendants, the claims pleaded in the statement of claim for wrongs allegedly committed to the fourth and fifth named defendants;
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> (i) against the third defendant
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> (ii) against the first defendant
>
> (iii) against the second defendant.

5. In the same ruling I refused an application from the third named defendant that the plaintiffs be required to establish a prima facie case that the fourth and fifth defendants (collectively referred to as "the Companies") are entitled to the reliefs claimed. I ruled that the issue should be determined in relation to the claims as pleaded. Having regard to the late withdrawal of the personal claims and a certain lack of clarity as to the factual basis of the wrongs alleged against the Companies, I also gave ancillary directions for clarification by the plaintiffs of the basis of the claims pleaded.

6. These were complied with and I heard oral evidence limited to the issues relevant to the reliance by the plaintiff on the exceptions to the rule in *Foss v. Harbottle* and the parties adduced certain documentary evidence relating to the factual matrix in which the claims are sought to be pursued and to the background to the claims pleaded.

7. At the conclusion of the evidence counsel for the third defendant, the first and second named defendants (who were appearing in person) and counsel for the plaintiffs furnished written submissions and made helpful oral submissions on the preliminary issue.

The rule in *Foss v. Harbottle*

8. The parties are in agreement as to the nature of the rule. In *O'Neill v. Ryan* [1993] I.L.R.M. 557 Blayney J. at 567 stated:

> "The rule is concerned with answering the question of who is the proper plaintiff to bring an action in respect of damage suffered by a company. It states that the proper plaintiff is the company itself. In the case of *Prudential Assurance Co. Ltd. v Newman Industries Ltd (No. 2)* [1982] Ch 204 the Court of Appeal said in its judgment at p. 219 referring to the case of *Gray v Lewis* (1873) LR 8 Ch App 1035:
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> > 'This case highlights what the rule in *Foss v Harbottle* is primarily concerned with, namely, is a plaintiff shareholder entitled to prosecute an action on behalf of the company for a wrong done to it, or ought the action to be struck out on the footing that it is for the company and not for a shareholder to sue? That is what *Foss v Harbottle* itself was about …'"

9. A derivative action such as sought to be pursued by the plaintiffs herein is permitted only as an exception to the rule in *Foss v. Harbottle* which, as the Court of Appeal in Prudential Assurance at p. 210 points out, forms part of the "elementary principle" that "A cannot, as a general rule, bring an action against B to recover damages or secure other relief on behalf of C for an injury done by B to C. C is the proper plaintiff because C is the party injured, and, therefore, the person in whom the cause of action is vested".

10. The classic restatement of the rule in *Foss v. Harbottle* and the exceptions to it is that of Jenkins L.J. in *Edwards v. Halliwell* [1950] 2 A.E.R. 1064 at 1066:

> "The rule in *Foss v. Harbottle* (1), as I understand it, comes to no more than this. First, the proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is prima facie the company or the association of persons itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company or association and on all its members by a simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company or association is in favour of what has been done, then *cadit quœstio*. No wrong had been done to the company or association and there is nothing in respect of which anyone can sue. If, on the other hand, a simple majority of members of the company or association is against what has been done, then there is no valid reason why the company or association itself should not sue. In my judgment, it is implicit in the rule that the matter relied on as constituting the cause of action should be a cause of action properly belonging to the general body of corporators or members of the company or association as opposed to a cause of action which some individual member can assert in his own right.
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> The cases falling within the general ambit of the rule are subject to certain exceptions. It has been noted in the course of argument that in cases where the act complained of is wholly *ultra vires* the company or association the rule has no application because there is no question of the transaction being confirmed by any majority. 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 control 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 it will be relaxed where necessary in the interests of justice."

11. The plaintiffs herein rely upon the exception identified by Jenkins L.J. normally referred to as "a fraud on the minority". They also submit that it and other decisions permit of a further general exception in "the interests of justice".

12. It is well established that it is not necessary to allege fraudulent conduct in the criminal sense to maintain a derivative action in reliance upon this exception. The ambit of this exception was stated as follows by Lord Davey in *Burland v. Earle* [1902] A.C. 83 at p. 93 (and cited with approval by Keane J. (as he then was) in the Supreme Court in *Crindle v. Wymes* [1998] 4 I.R. 567 at 593):

> "The cases in which the minority can maintain such an action are … confined to those in which the acts complained of are of a fraudulent character or beyond the powers of the company. A familiar example is where the majority are endeavouring directly or indirectly to appropriate to themselves money, property, or advantages which belong to the company, or in which the other shareholders are entitled to participate …"

13. Counsel for the third named defendant appear to me correct in their submission that the cases in which a plaintiff has been permitted to proceed with a derivative action in reliance upon the exception of the alleged wrongs constituting "a fraud on the minority" all include at minimum an allegation that the wrongdoers have derived some personal benefit from the wrongs alleged. Keane J. in *Crindle Investments v. Wymes* refers to the following passage from Templeman J., as he then was, in *Daniels v. Daniels* [1978] Ch. 406 where, at p. 413, he 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."

14. Having cited the above, Keane J. stated:

> "In the context of the present case, it is unnecessary to say whether that interesting passage states the law too widely."

15. It is unnecessary in the context of this case to consider whether Templeman J. was intending to expand the meaning of "fraud" or to develop a further exception "in the interests of justice" to permit a claim to be pursued by minority shareholders where the action alleges that the majority benefited wrongly at the expense of the company as a result of the alleged negligence. On either basis I would respectfully agree that such actions may come within the class of action in which a court should permit minority shareholders to pursue a derivative claim for the very reasons set out by Templeman J. However, as far as the facts of this case are concerned, even if the court accepts that a plaintiff should be permitted to pursue such a claim by way of derivative action, it is clear that the principle as stated by Templeman J. is limited to circumstances in which it is alleged that a majority benefited from the alleged wrongdoing.

16. Counsel for the plaintiffs have not referred to any decision in which the exception was extended to an allegation of wrongdoing by a majority which is not alleged to benefit them at the expense of the company.

17. The conclusion I have reached appears supported by the view taken in Joffe *Minority Shareholders: Law Practice and Procedure*, 2nd edition (Tottel) where at paragraph 1.43 the authors' state:

> "It is an essential element of the concept of 'fraud on the minority' that the persons engaging in the fraudulent conduct should have received some benefit. It is for this reason that negligence on the part of a director without any corresponding benefit to himself is not actionable by means of a derivative claim under the 'fraud on the minority' principle."

18. In *Pavlides v. Jensen* [1956] 1 Ch. 565 a minority shareholder was not permitted to pursue a derivative action claiming damages for negligence against directors arising out of an alleged sale of a mine at an undervalue as, *inter alia*, there was no allegation that the directors had appropriated to themselves any assets of the company.

19. The second relevant aspect of the exception of alleged wrongs constituting a "fraud on the minority" is that the alleged wrongdoers are in control of the company.

20. In considering whether or not the defendants who are alleged to be wrongdoers are in control of the Companies the plaintiffs submit that the court should apply a broad concept of "control" and rely upon the test applied by Jessel M.R. in *Russell v. Wakefield Waterworks Co.* (1875) L.R. 20 Eq., 474 at 482:

> "It is not necessary that the corporation should absolutely refuse by vote at the general meeting, if it can be shewn either that the wrong-doer had command of the majority of the votes, so that it would be absurd to call the meeting; or if it can be shewn that there has been a general meeting substantially approving of what has been done; or if it can be shewn from the acts of the corporation as a corporation, distinguished from the mere acts of the directors of it, that they have approved of what has been done, and have allowed a long time to elapse without interfering, so that they do not intend and are not willing to sue. In all those cases the same doctrine applies, and the individual corporator may maintain the suit."

21. In *Prudential Assurance Company* the Court of Appeal at p. 219 stated:

> "… what is meant by 'control', which embraces a broad spectrum extending from an overall absolute majority of votes at one end, to a majority of votes at the other end made up of those likely to be cast by the delinquent himself plus those voting with him as a result of influence or apathy."

22. I would respectfully agree with the above approaches. What constitutes 'control' must be determined in a common sense way in the context of the relevant facts and company structure.

23. 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 C*rindle 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.

24. 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."

25. 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.

Factual matrix of claims.

26. The parties are in agreement that the preliminary issue as to the plaintiffs' entitlement to pursue the derivative actions on behalf of the Companies against the first to third defendants is a mixed question of fact and law. It is further agreed that the issue must be determined in the relevant factual matrix. The plaintiffs at the direction of the court prepared a statement of the facts upon which they rely. Evidence was given by the plaintiffs and third named defendant and a significant number of documents in the books of core documents and books of the minutes of meetings of the directors were referred to in submission without objection from any party. Accordingly I have considered them as being in evidence.

27. The following is a brief summary of the factual background to the present proceedings. Most of the facts are not in dispute. Where they are, this summary includes my findings of fact. The plaintiffs and first to third defendants are all businessmen. The plaintiffs prior to 2001 were involved together in the environmental technology industry. The second defendant was the inventor of a separator of oil and water which has particular application in the food industry for the purpose of removing liquid greases, fat and oils from waste water prior to going into the drainage system. The first defendant is the son of the second defendant. Both are resident in the U.K. The product manufactured in accordance with the invention of the second defendant was known as "Fatstrippa" and the first defendant was primarily involved in the development and distribution of the product in the U.K.

28. The third defendant is resident in Northern Ireland and prior to 2001 did business with the plaintiffs.

29. The plaintiffs were introduced to the first and second defendants and the plaintiffs in turn introduced the third defendant to the first and second defendants. By 30th April, 2001, all five had agreed to become equal twenty per cent shareholders in the two companies which are the fourth and fifth named defendants. On that day shareholders' agreements prepared by Arthur Cox & Co. were executed. Also on 30th April, 2001, the second defendant assigned to the fourth defendant his interest in the then application for a patent for his invention. On the same day the fourth defendant granted an exclusive licence to the fifth defendant to manufacture and sell products coming within the claim of the patent and otherwise exploit the patent.

30. It appears from the minutes that the fourth defendant subsequently became the holder of the patent in six European countries including Ireland and the original licence to the fifth defendant was altered from an exclusive to a non-exclusive licence.

31. In accordance with the shareholders' agreements all five shareholders were also to be the directors of each of the Companies. Memoranda and articles of association were approved for the Companies. These permitted the appointment of alternate directors.

32. Each Company was a party to its shareholders' agreement. The agreements contain a list of the decisions and transactions which require consent of 80% of the shareholders. These do not include commencement of proceedings. They also contain provisions in relation to non-competition with the business of the company and non-disclosure of trade secrets or confidential information in relation to the company.

33. The company had no employees. Prior to 2004 the second defendant acted as chairman of the Board and the second plaintiff had been named as Chief Executive Officer and/or Managing Director of the fifth defendant. The nature of that appointment is a matter of dispute.

34. The Fatstrippa product was manufactured by a company in Donegal for the fifth defendant. The distribution of the product in the U.K. was carried out by Baden-Powell Environmental Technologies Limited ("BPET"), a company in which the first defendant had a significant interest. The greater part of the business of the fifth defendant appears to have been in the U.K.

35. The five directors held regular board meetings. A book of minutes and transcripts of certain minutes was handed into court. The minutes sometimes expressly refer to the meeting as a meeting of the Board of the fifth defendant and sometimes just "Fatstrippa". Nothing turns on this. The parties in submission did not distinguish between meetings of the fourth or fifth defendants. The exploitation of the patented product in other countries was regularly discussed. By the autumn of 2003 the board of directors was aware that contacts had been made by the first defendant with certain Americans, including Mr. Doug Samuelson, with a view to exploiting the Fatstrippa product in the U.S. By this time Mr. Paul O'Kelly (who appears to have been introduced by the plaintiffs) of O'Kelly Sutton who were then accountants to the Companies was also carrying out consultancy work in particular in relation to the possible U.S. business. He reported on the potential U.S. business at a board meeting in October, 2003. The report appears to have raised queries about the proposed U.S. contacts.

36. In early 2004, difficulties arose with the U.K. distributor, BPET. It became insolvent. A new U.K. distributor "Fatstrippa U.K." was proposed. Ms. Pamela Lewis, an accountant who was already an advisor to the first and second defendant, was being proposed as a shareholder and director of Fatstrippa U.K. (FSUK). At this time there was also concern about the amount of the outstanding debt from BPET to the fifth defendant.

37. The third defendant gave uncontested evidence that for some time there was a significant difference of approach between the second plaintiff on the one hand and the first and second defendants on the other as to how worldwide expansion should take place. The second plaintiff favoured what was referred to as "a big bang" approach with high borrowings. The first and second defendants favoured a more low-key licensing system. It appears that tension had increased by early autumn of 2004 due in part to the insolvency of BPET and at board level no significant progress had been made in relation to business in the U.S.

38. In the autumn of 2004 the second plaintiff was contacted by a Mr. David Lawson making certain allegations in relation to the Fatstrippa business which were of immediate concern. The second plaintiff organised the establishment of a sub-committee of the Board to investigate these allegations. He travelled to London to do so. The sub-committee also retained Paul O'Kelly to work with them. In the course of the second plaintiff's investigations in London he became aware of what he perceived were even more serious matters concerning alleged activities of both the first and second defendants in relation to the Fatstrippa product in the U.S. and in China. No evidence was given of the detail of these matters save to the extent that they are referred to in the minutes of the board meeting of 9th November, 2004, and subsequent minutes, all of which were put into evidence. Some difficulties arise in relation to those minutes as they are not signed and for some meetings there is more than one version of the minutes. A board meeting was held on 9th November, 2004, at which the plaintiffs and the first to third defendants were present. Mr. Paul O'Kelly was invited by the second plaintiff to join the meeting, which he did, (at least for part of same) albeit with objection from the first and second defendants. The second plaintiff appears to have reported on his investigations and Mr. O'Kelly also reported on what he had learned and outlined certain steps which he considered should be taken by the Company.

39. The court is not concerned on this issue with the accuracy of the allegations made or even what precisely was decided at the meeting of 9th November about which there appears to be dispute. It is sufficient for the preliminary issue to understand the nature of the allegations and the general thrust of the decisions taken.

40. The second plaintiff appears to have learnt in the course of the investigations what he perceived as disturbing additional information surrounding the insolvency of BPET and the use to which monies earned by that company had been put. Alleged wrongdoing by the first defendant was central to those allegations.

41. He also learnt of significant ongoing contacts between the first defendant and a number of U.S. parties. He learnt of ongoing involvement of the second defendant with U.S. parties including, it was alleged, receiving them in London. He learnt of the manufacture in China of products allegedly using Fatstrippa technology and the first defendant's involvement in China. He learnt of the proximate arrival of those products from China to the U.S.

42. The plaintiffs and the third defendant were all unaware of any of this activity until the investigation. The first and second defendants acknowledged certain of the alleged activities and that these had been undertaken without disclosure to the remaining members of the board.

43. The second plaintiff, prior to and in the course of the Board meeting of 9th November, took advice from Arthur Cox & Co.

44. In the course of the meeting, the second plaintiff proposed that the third defendant replace the second defendant as chairman of the board. The third defendant agreed to consider this and subsequently, with the agreement of the second defendant, he agreed to take over as chairman.

45. As already noted, there is a dispute as to precisely what was decided at the meeting. A copy of a handwritten resolution signed by all five directors and shareholders was put in evidence. This reads:

> "That the board appoints a member/members to lead the integration and regularisation of all existing Fatstrippa activities, assets, intellectual property, patents, etc. globally. And that the company makes a resolution to appoint a nominated person to act on its behalf in the integration and regularisation of all existing Fatstrippa activities, assets, intellectual property, patents etc. globally, and that only board approved companies can be allowed to represent us in future. This is agreed by all board members as follows. This position to be reviewed by the board in ninety days."

46. It is not in dispute that the third defendant agreed to become the member of the board referred to in this resolution. It is also not in dispute that Mr. Paul O'Kelly was to be the nominated person. The relationship between the third defendant and Mr. Paul O'Kelly is in dispute. However, nothing turns on that for the preliminary issue. The third defendant made contact with certain of the American parties. He also had certain contacts with Messrs. Arthur Cox & Co. and with Mr. Paul O'Kelly. Central to the claim now sought to be made by way of derivative action against the third defendant is an allegation that he acted in breach of duty to the Companies in failing to sanction and authorise Arthur Cox & Co. to instruct a firm of U.S. attorneys in California to commence proceedings there to obtain orders to enable seizure of allegedly counterfeit separator products in the U.S. which, it was alleged, infringed the rights of the

fourth and fifth defendants. It is also alleged that the third defendant wrongfully and in breach of duty terminated the appointment of Mr. O'Kelly.

47. The third defendant has given evidence of his explanations for why he took the steps he did and did not take other steps subsequent to the meeting of 9th November in furtherance of the resolution of the Board. It forms no part of the decision on the preliminary issue to determine whether such actions were reasonable or, as alleged by the plaintiffs, in breach of the duty which he owed to the fourth and fifth named defendants.

48. The third defendant sought to hold a board meeting in Northern Ireland on 23rd November. The plaintiffs were unwilling to attend such a meeting.

49. The next board meeting was held on 2nd December. The third defendant acted as chairman of that meeting. Ms. Pamela Lewis attended as alternate for the second defendant. At that meeting there was a review of what had been done since the last meeting. The plaintiffs disputed the third defendant's understanding of the role given to him by the resolution of the previous meeting. Following much discussion at that meeting it is not in dispute that it was unanimously resolved that "regularisation of the Company's interest in the U.S. will be pursued through negotiation with the Americans rather than legal action". Further detailed decisions were taken as to how the third defendant as Chairman should proceed and that the Chairman, the second plaintiff and possibly the first defendant should go to the U.S. to negotiate with the Americans. The third defendant and second plaintiff did travel to the U.S. in early 2005 but negotiations were not successful.

50. A board meeting was held on 14th February, 2005. At that meeting Ms. Pamela Lewis again attended but as an alternate director for the second defendant and the second defendant is recorded as attending as an alternate director for the first defendant. At that meeting the third defendant stated that he was formally offering all his shares in the Companies for sale and invited the other directors to discuss the mechanism and price for the transaction. He was requested by the second plaintiff and the second defendant to reconsider and urged to withdraw his offer. Ms. Lewis suggested that he remain in his current capacity (presumably as Chairman) for at least another month until after the next board meeting. At that meeting there appears to have been considerable discussion as to a way forward for the Company, notwithstanding the then existing disagreements between the members of the board. Two decisions of relevance were taken.

> (i) That Mr. Paul O'Kelly and Ms. Pamela Lewis (and at the third defendant's option a nominee of him) formulate a business brief for the Company to set out broad business goals and strategy of the Company and that such brief be presented to the next meeting of the board.
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> (ii) The Company not take any action against the first defendant arising out of his involvement in BPET and that Ms. Pamela Lewis not take any action against the second plaintiff or Mr. O'Kelly for alleged damage to her professional reputation caused by their alleged actions. (No evidence was given as to what this latter matter related)

51. Agreement also seems to have been reached at that meeting about certain other normal issues relating to the business of the Company including development in South Africa and audit and other accountancy matters.

52. The third defendant did not dispose of his shares. The first plaintiff wrote expressing an interest in purchasing the shares on 17th February and seeking a price and the required mechanism. This does not appear to have been responded to and not then pursued.

53. The report prepared by Ms. Pamela Lewis and Mr. Paul O'Kelly was presented to the board meeting of 14th April, 2005. That board meeting was attended by the plaintiffs, second and third defendants and Ms. Pamela Lewis as alternate for the first defendant. Following the presentation of the report the minutes indicate that a list of agreed urgent issues was drawn up and responsibility allocated to individual persons. In relation to the U.S.A. under the heading of 'action to be taken', it is recorded "It was acknowledged that the meeting with the Americans attended by SL [third defendant] and KM [second plaintiff] had not generated any solution. In the light of this the board considered that they should arrange another meeting with the Americans to see if there is anything that can be salvaged from the relationship. Under the heading of 'persons responsible for this matter' it is recorded "AO [second defendant] and PL [Pamela Lewis] to arrange meeting with the Americans to see if they can find any way forward."

54. At the same meeting the second plaintiff proposed and the first plaintiff seconded "that this board immediately proceed to take action against BPET and Jonathan Owen". The proposals were not carried, the other three directors present voting against.

55. In the course of his evidence, the second plaintiff was asked whether he had proposed that the Company take action against the first defendant arising out of his alleged activities in the U.S. In response he referred to this meeting and this minute. I have concluded as a matter of probability that his recollection is mistaken and that, having regard to the proposals in relation to the U.S. at that meeting and the proposal of litigation referring to BPET, that the then intended litigation was confined to the alleged wrongdoing surrounding the insolvency of BPET.

56. No further board meetings were held until 17th August, 2005.

57. Notwithstanding, relations between the plaintiffs on the one hand and the first and second defendants and Ms. Lewis on the other appear to have deteriorated further. This appears to have been partly caused by further facts ascertained by the plaintiffs in relation to involvements of the first and second defendants and Ms. Lewis in the American activities. The relationship between the second plaintiff and the third defendant also appears to have seriously deteriorated in relation to matters not relevant to the fourth and fifth defendants herein but giving rise to an extremely acrimonious telephone conversation which the second plaintiff in evidence accepted was inappropriate on his behalf.

58. A board meeting was called for on 17th August in the Great Southern Hotel at Dublin Airport, to commence at 2 p.m. or 2.30 p.m. The level of mistrust and suspicion between the plaintiffs and the other board members was such that the plaintiffs contacted the hotel, ascertained that the room was booked from 10 a.m., visited the room and left a recording device in the room. A preliminary meeting was held during the morning between the second and third defendants and Ms. Lewis at which the removal of the title of CEO and/or Managing Director from the second plaintiff was discussed. The second and third defendants and Ms. Lewis were unaware of the recording. The plaintiffs were unaware of the content at the time of the board meeting in the afternoon of 17th August. There were further disputes as to the manner in which the existence of the recording was disclosed by the plaintiffs as part of the discovery process. Nothing turns on that for the determination of the preliminary issue. I have read the transcripts of the morning and afternoon meetings of 17th August.

59. The board meeting on the afternoon of 17th August was extremely acrimonious. The second plaintiff, supported by the first

plaintiff, sought to introduce a series of documents and proposed resolution to which he required the other members of the board present to agree. Those documents have not been put in evidence. What is clear from the transcript is that there were extremely heated exchanges, in particular between the second plaintiff on the one hand and the second defendant and Ms. Lewis on the other. The discussion at times appears irrational and certainly not worthy of the parties who all appear in separate lives to have been successful business people.

60. I have considered carefully the evidence adduced in relation to the morning meeting of 17th August between Ms. Lewis, the second defendant and third defendant and the afternoon board meeting. That evidence includes the transcripts, the minutes and the oral evidence given by the second plaintiff and third defendant. I have had the benefit of observing the second plaintiff and third defendant in the witness box. The plaintiffs rely in part on these meetings of 17th August in support of the contention that the third defendant with the first and second defendants should for the purposes of the preliminary issue be regarded as allegedly wrongdoing shareholders in control of the Company.

61. I have concluded that the evidence in relation to the actions of the third defendant prior to, at the meeting of 17th August and subsequently prior to the issue of proceedings does not support such a conclusion. Rather I have formed the view that the third defendant at this time was continuing to discharge his role as Chairman of the Company and, where possible, to avoid conflicts and get the directors to work together in the interests of the Company. I accept his evidence that at the morning meeting he attempted to and did procure the withdrawal by the second defendant of a letter which he knew would exacerbate difficulties with the second plaintiff. I formed the view that he maintained an open mind as to the actions which should be taken in the interests of the Companies. In furtherance of this approach, as recorded, he requested the plaintiffs to prepare five sets of documents outlining charges and proposed solutions and enclosing documentation which they consider as evidence of the charges. Those charges appear to relate to the first and second defendants.

62. The third defendant has acknowledged in evidence that he did decide that the title of CEO and/or Managing Director should be removed from the second plaintiff. I am satisfied on his evidence that that is a decision he took in what he perceived to be in the interests of the Company having regard to the behaviour of the second plaintiff as he then perceived it.

63. On 9th September, 2005, Messrs. Lavelle Coleman, then solicitors for the plaintiffs, wrote to the third named defendant setting out allegations which form the subject matter of these proceedings and seeking certain undertakings and in default threatening proceedings. This was responded to on 19th September, 2005, essentially disputing the allegations and refusing the undertakings and indicating an intention to act properly and in a manner that appropriately advanced the Company's position.

64. The summons was issued on 28th September, 2005, and served on the third defendant on 30th September, 2005.

Nature of Proceedings

65. These proceedings are different to many of the authorities to which I was referred as they do not comprise the same claim against all defendants who are alleged to be jointly in control of the Companies. Rather they principally comprise distinct claims against each of the first, second and third defendants. There is minimal overlap between the claims pleaded against third defendant and those pleaded against first and second defendants. There is a little more between first and second defendants. It is therefore necessary to consider claims against defendants separately.

Claim against third defendant

66. The claim pleaded against the third defendant which is sought to be pursued as a derivative action is an allegation of negligence and breach of duty including breach of fiduciary duty to the fourth and fifth named defendants in respect of the matters particularised at paragraph 14(a), (b), (c), (d), (e), (f) and (m) of the statement of claim. These are:

> (a) Allowing or permitting the intellectual property, trade secrets and confidential information of the fourth and fifth named defendants to be infringed and violated by other parties.
>
> (b) Failing to take any or any appropriate or adequate steps to protect and secure the intellectual property rights of the fourth and fifth named defendants.
>
> (c) Failing to instruct solicitors to pursue and restrain infringement of the intellectual property rights of the fourth and fifth named defendants.
>
> (d) Frustrating and obstructing the implementation of the resolution of the board of directors of the fourth and firth named defendants passed on the 9th day of November, 2004.
>
> (e) Terminating the appointment of Mr. Paul O'Kelly and the activities of the sub-committee appointed by the board of directors of the fourth and fifth named defendants to regularise and integrate all operations of both companies.
>
> (f) Conspired and collaborated with each other to frustrate and obstruct the implementation of the resolutions passed on the 9th day of November, 2004.
>
> (m) Attempted to remove the second named plaintiff from his position as Chief Executive Officer and Managing Director of the fifth named defendant.

67. Those allegations are further particularised in the replies to particulars and indeed set out in paragraphs 13(i) - (iv) inclusive of the statement of claim.

68. As appears, the allegations primarily relate to the role conferred on him by the resolution of 9th November, 2004, and his alleged failures in the period immediately following that resolution.

69. The one separate and distinct matter is the alleged attempt to remove the second plaintiff from his position as Chief Executive Officer and Managing Director of the fifth defendant.

70. In the replies to particulars the plaintiffs confirm that no allegation of conversion is being made against the third defendant and that there is no allegation that he failed to account for any funds due to the fifth defendant. In the course of submission it was properly confirmed by counsel on behalf of the plaintiffs that it does not form part of any allegation against the third defendant that he benefited improperly at the expense of the fourth or fifth named defendant by reason of any of the alleged breach of duty or negligence.

71. For the reasons set out above, I have formed a view that in order that a claim be considered one which comes within the exception to the rule in *Foss v. Harbottle* as being a "fraud" on the minority, it must include an allegation that the defendant has wrongly benefited at the expense of the company. There being no such allegation in the claim sought to be made against the third defendant herein I have concluded that the plaintiffs have failed on this account alone to bring themselves within the exception to the rule in *Foss v. Harbottle*.

72. Insofar as the plaintiffs seek to make a claim alleging wrongful attempted removal of the second plaintiff from his position as CEO and/or Managing Director, in addition to the above, that does not appear to me to be a claim which could ever be pursued by the fourth or fifth named defendants. The cause of action, if any, subsists in the second plaintiff personally.

73. Having regard to these conclusions it is not necessary for me to consider whether in relation to the exception of "fraud on the minority" and the wrongs alleged against the third defendant he should be considered to be part of a group of shareholders or directors in "control" of the Companies. It may be relevant to any right to proceed "in the interests of justice" and the pursuit of claims against the first and second defendant.

74. I have concluded that he should not be so regarded. The third defendant became a director and shareholder of the fourth and fifth named defendants at the behest of the plaintiffs with whom he had prior business connections. He has no business or other links with the first and second defendants. For the reasons set out above and having regard to the evidence, much of which is not in dispute and the actions taken by the board and in particular the third defendant from November, 2004 until the commencement of proceedings in September, 2005, I have concluded that the plaintiffs have failed to satisfy me on the normal balance of probabilities that he forms part of a controlling majority of either of the Companies applying the broad concept of 'control' set out above.

75. The final question is whether the proceedings should be permitted to proceed against the third defendant "in the interests of justice". My conclusion in accordance with the principles set out above is that the plaintiffs have not established the existence of any such injustice or interests of justice on the fact herein. I have reached this conclusion having regard to the nature of the wrongs alleged, the fact that I have concluded that the third defendant should not be regarded as part of a controlling majority and the positions of each of the plaintiffs and third defendant as equal 20% shareholders and directors of the Companies.

Claim against first and second defendant

76. The claims pleaded against the first defendant do not include any express plea that he acted fraudulently. Nevertheless, they do include claims that he personally wrongfully benefited at the expense of the fourth or fifth named defendant. Such allegations are included in the claims at paragraph 13(i), (ii), (iii), (v) and (vi) of the statement of claim. These are:

> (i) Acting without authority and contrary to the interests of the plaintiffs in selling a licence to distribute the separator product to a company partly owned and/or controlled by the first named defendant without obtaining approval of the board of directors and the fourth and fifth named defendants before so doing.
>
> (ii) Failed to account for funds paid to him on foot of contracts which he made with other third party companies to licence the distribution of the separator product which licences were not agreed to or approved by the board of directors of both companies.
>
> (iii) Procure the payment of Stg£10,000 from one David Lawson purporting to grant to him a licence to sell the separator product in the United Kingdom without the authorisation or sanction of the board of directors of the fifth named defendant.
>
> (iv) …
>
> (v) Attempted to register the trade mark "Fatstrippa" in his own name in the United States of America and in so doing sought to infringe the intellectual property of the fourth named defendant. Subsequently the first named defendant agreed to transfer the application to register "Fatstrippa" as a trade mark in the United States of America to the fourth named defendant but despite discharge of costs associated with the transfer, he failed to do so.
>
> (vi) Allowed Goslyn LLC, a company of which he owned a 35% shareholding, to represent that Fatstrippa Corporation's customers were the customers of Goslyn LLC when this was not and is not the case.

77. The claims made in the above paragraphs against the first defendant are made against him alone and not against the second or third defendants.

78. There is one further claim made which is made both against the first defendant and the second defendant. It is that set out at paragraph 13(iv) in relation to the first defendant and (ii) in relation to the second defendant. It alleges that the first defendant:

> (iv) Collaborated and conspired with the second named defendant and various third parties in the United States of America to incorporate various companies including Fatstrippa LLC, Fatstrippa General LLC and Goslyn LLC to which companies he provided drawings, trade secrets, intellectual property and confidential information concerning the separator product to assist in the development of a similar product using technology owned by the fourth named defendant. In addition the first named defendant advised on patenting the product developed in the United States of America.

79. There was one further relevant claim against the second defendant, namely that at paragraph (i) that he acted wrongfully and unlawfully in:

> (i) Allowing Baden-Powell Environmental Technologies Limited, a company controlled by the first named defendant, to obtain €300,000 credit contrary to the credit limit in place in the fifth named defendant.

80. Applying the law set out above in the manner most favourable to the plaintiffs each of the above claims may be considered as an allegation that the pleaded breach of duty not only harmed the Companies but benefited either directly or indirectly one or other of the first or second defendants. Having regard to the relationship of father and son, I have assumed that those defendants should be considered as jointly in control of 40% of each of the Companies. I make this assumption without necessarily concluding that the plaintiffs have established as a matter of probability that the second defendant would necessarily vote with the first defendant in the event that there were a proposal to institute proceedings against the first defendant.

81. Notwithstanding such assumption, the first and second defendants collectively are not in "control" of either of these companies.

Together they are a minority. For the reasons already set out, applying the broad definition of control referred to above, it does not appear to me that the plaintiffs have established that the third defendant would necessarily vote with the first and second defendants as a result of "influence or apathy" or otherwise. Hence they cannot be considered to be in control.

82. Accordingly, whilst the nature of the claims against the first and second defendants are such that they might come within the exception of "fraud on a minority" (when applied in the broad sense set out above), the plaintiffs have failed to establish that in respect of those claims the first and second defendants are in control and they are a minority such that they should be permitted to pursue such claims as a derivative action. Such alleged wrongdoers are together a minority and the remaining shareholders capable of forming a majority.

83. I have also considered whether in respect of the claims against the first and second defendants there is any other exceptional circumstance in accordance with the principles set out above which would justify permitting the claims to proceed "in the interests of justice" or to avoid an injustice. I have concluded that the plaintiffs have not established any such circumstances.

84. Central to the rationale underlying the rule in *Foss v. Harbottle* and the exceptions to it is that the courts should not interfere with the internal management of a company. It is a matter for the majority of the board of directors or shareholders to determine in an appropriate case whether litigation should be commenced by, and in the name of, a company against an allegedly wrongdoing director or shareholder or directors or shareholders (at least where the alleged wrongdoers are not in control of the company). Often such decisions will be difficult and a matter of delicate judgment as to whether it is in the interests of a company to commence what may be costly litigation against a director or shareholder, particularly where such person may also be necessary to the future development and progress of the company. The plaintiffs and the third defendant are the shareholders and directors along with the first and second defendants of the Companies. It appears to me consistent with the principles underlying the rule in *Foss v. Harbottle*, the exceptions to it and the law relating to companies that the decision as to whether or not to pursue claims such as pleaded against the first or second defendant should on the facts herein be taken by a majority of the board of directors and/or shareholders in general meeting and it is not a matter for the courts to interfere.

Conclusion

85. On the preliminary issue I have concluded the plaintiffs have failed to establish that they should be permitted to pursue by way of derivative action the claims pleaded against the first, second or third defendants for alleged wrongs and breach of duty to the fourth and fifth defendants.

86. I will hear counsel as to the form of order having regard to the confirmation given at the hearing that the plaintiffs are not now pursuing the personal claims included in the proceedings.