

IN THE GRAND COURT OF THE CAYMAN ISLANDS
BEFORE JUSTICE KIRSTY-ANN GUNN
IN CHAMBERS

Cause No. FAM0227/2017



M.S.

Petitioner

AND

F.S.

Respondent

Appearances: Mr Todd QC and Mr Yates QC instructed by Mr D. McGrath and Miss S Ismail of McGrath Tonner for the Petitioner
Mr Cusworth QC instructed by Mr K Broadhurst and Miss Y Mullen of Broadhurst LLC for the Respondent

Heard: 29th May 2020

Judgment: 4th June 2020

These proceedings were heard in private. The judge has given permission for a redacted version of the judgment to be released at this time. Redactions have been made to protect the privacy of the children and to prevent commercially sensitive information from being made public. Nothing shall be published which may lead to the identification of the children.

JUDGMENT

1. Pursuant to my judgment on 28 April 2020 the husband and wife are to be equal shareholders and directors of Company U ("Company U"; previously referred to as the "residual business"). There is a third director, Mr RS, who is not party to these proceedings. The husband and wife have been unable to effectively work together on a number of company related issues resulting in the application before me.

THE APPLICATION

2. This is the wife's summons dated 25 May 2020 in which she seeks orders that –
- (a) The parties be made equal shareholders;
 - (b) The husband shall vote in favour of, or be restrained from voting against, her proposed resolution that an extraordinary general meeting be called at which a vote is taken to remove Mr RS as director and a new independent professional director be appointed in his place;
 - (c) The husband be restrained from voting on any other motion until the wife's proposed resolutions at (b) above have been put and passed;
 - (d) Neither party shall take any steps which shall have the effect of diminishing the value of their respective shareholdings except by agreement;
 - (e) The definition of "ordinary and proper course of business" shall be that as understood at common law;
 - (f) That each party shall take reasonable steps to ensure that the other party has full access to all papers of the company which a director would ordinarily be expected to have access to;
 - (g) Such other relief as the court deems appropriate; and
 - (h) Costs.



THE ISSUES

3. Mr RS is a long-standing employee and director of Company U. As part of the sale of assets to G Inc ("G Inc"), Mr RS has agreed to move across to G Inc. He has not yet taken up that position as G Inc does not yet have the necessary license to operate in the Cayman Islands and, therefore, Mr RS remains an employee of Company U. The husband's evidence is that the transition agreement between Company U and G Inc calls for Mr RS and the husband to continue working closely together.

4. Mr Todd QC narrowed the issues for the court to: should the husband be mandated to vote in favour of removing Mr RS as director of Company U and replaced by an independent professional director? He submitted that with the appointment of an independent professional director all other concerns raised by the wife about the operation of the company could be addressed in the normal course of business by the newly constituted board of directors.
5. The husband opposes the wife's application, arguing that there is no just cause for removing Mr RS as a director of Company U at this time. Instead the husband proposes that the wife be required to appoint an accountant to act on her behalf on the board.
6. Both Mr Todd QC and Mr Cusworth QC have made reference to paragraph 146 of my judgment speaking to the monetization of Company U. For the avoidance of doubt, the process of monetization is that there should first be a valuation of Company U. Once that has been done, the husband then has the option to purchase the wife's half of the business. Only if he rejects that option does the process progress to the company being put up for sale. In the year given to complete this process (including sale to a third party) the business is to continue operating in the usual way. I repeat what I expressed in correspondence to the parties' attorneys¹:

"The judgment does not seek to curtail the parties' rights, duties and obligations as directors and shareholders to meet company needs and obligations (both past, present and future) and to operate the company in the normal course of business. This includes any pre-existing share plan if previously agreed by the directors. The parties and company are not confined to preparing for sale at this time."

I add to this clarification that "meeting company needs and obligations" includes that parties ensuring that Company U has sufficient working capital to meet its debts, operating expenses and other such usual liabilities.



¹ Email dated 13 May 2020



7. I mention this now as the husband filed a very last-minute summons seeking directions on the appointment of a SJE to value Company U. This summons was filed far too late to be considered at this hearing. However at the end of today's hearing I will be making directions with a view to having that summons listed at everyone's earliest convenience. The question of who shall be the directors of the company is an important one to ensure good governance during the monetization process. My judgment required the parties to be equal shareholders and directors vis-à-vis each other which, according to the agenda, is to be resolved at the upcoming meeting of the board of directors. For the avoidance of doubt, I did not direct that the parties be the only directors, merely equal to one another. The matter was addressed in my earlier judgment and the process is in hand and so I see no need to make an order as sought in paragraph 1 of the wife's summons. For the avoidance of doubt, the board continues to have the power to add and remove directors in the usual manner and the company shall continue to operate in the ordinary and proper course of business.

8. At the heart of the wife's case is her objection to the husband's motion that former and current employees of Company U, including Mr RS, be given one-off *ex gratia* payments in recognition of their past service to the company. The wife argues that there is neither a contractual obligation nor good commercial reason for such payments and so are contrary to the interests of the company and shareholders. Any payments would be made using the proceeds from the sale of the Company U assets to G Inc which would ordinarily go to the shareholders by way of dividends; consequently, the wife considers the husband to be attempting to "give away" funds owed to her under the judgment.

9. The wife's position is that she believes that Mr RS, who it is proposed would receive US\$ X under the scheme, has aligned himself with the husband so that the husband will have the majority needed to pass this and other motions. The wife argues that the US\$ X payment to Mr RS would be a *quasi*-reward for giving evidence in favour of the husband. She considers that the husband and Mr RS are such close allies that in reality the husband will have two votes to the wife's one vote, leaving her powerless to stop the husband from "run[ning] roughshod over [her] rights as director and shareholder". She also asserts that Mr RS is hopelessly conflicted between his duties as a director of Company U and those as an employee of G Inc.

10. On 16 April 2010 the husband, through his attorneys, wrote to the wife speaking of Mr RS possibly having a conflict and that he would likely resign -

“The company shall expand its board of directors. At this time, the parties and Mr [RS] are the three directors of the Company. Given that Mr [RS] has accepted a position with [G Inc] it is anticipated that he may no longer be able to serve as a director. In order to address his possible departure and to bring greater depth to the board our client believes it would be in the best interest of the Company to expand the board of directors to five individuals. Our client anticipates that the most appropriate directors would be current shareholders in the Company given that they will be familiar with the company and their interest will align with the parties as they are also shareholders. Our client is giving consideration to potential candidates and would invite your client to do the same. It is hoped that agreement can be reached and the new directors appointed next month.”



11. Mr Todd argues that the husband’s attorney were unnecessarily hesitant as the conflict is unquestionable. The wife responded to the husband’s letter in the affirmative proposing the appointment of a combination of shareholders and independent directors. The wife felt so strongly about the issue of Mr RS’s resignation that she instructed her attorneys to write directly to him setting out her view of the conflict which they did on 19 May 2020² -

“Our client is not privy to the terms or details of your new role at [G Inc] however, in view of your industry knowledge, considerable experience and skill set, she proceeds on the basis that it is a senior position. Whatever your position as an employee of [G Inc], you have at the very least an employee’s implied duty of fidelity to your new employer. Some of the specific obligations of your overarching duty of trust and confidence to your new employer include but are not limited to:

- The duty not to disrupt your employer’s business;*
- The duty not to compete;*
- The duty not to solicit the employer’s customers;*
- The duty not to entice employees;*
- The duty to disclose wrongdoing to your employer;*
- The duty of confidentiality.*

² At page 241 of the hearing bundle



Depending upon the seniority of your role at [G Inc], and we reiterate that our client is not privy to this information, it is possible that in addition to your duty of fidelity as an employee, you may also have fiduciary duties to your employer which may well require you to subordinate your personal interests to the interests of [G Inc]. If you do indeed owe your new employer the fiduciary duty of loyalty, part of that obligation requires you to avoid being placed in a position where your interest conflicts with your obligations to [G Inc] and to avoid making an unauthorised profit. At the same time, and for the moment at least, you remain one of the three directors of [Company U]. That directorship obviously means that you owe fiduciary duties to [Company U]. It is not our intention to descend in to detailed principles of company law, but part of your fiduciary duty to [Company U] means that you must always act in good faith and in the best interests of the Company. Any breach of a common law or fiduciary duty could result in an action to recover property or to obtain payment of damages from you as compensation for any loss incurred through a breach of your fiduciary duty. As a director of [Company U], you must subordinate your personal interest to those of [Company U].

Whether your obligations to [G Inc] are limited to the duty of fidelity or in addition include the higher obligations of a fiduciary, we say that there is an impossible conflict between your two roles as employee of [G Inc] and director of [Company U]. The conflict is so obvious and fundamental that it is impossible for you properly to continue in both roles."

12. By way of an example of the position conflict, my attention was drawn to the existence of a report that Company U was seeking legal advice as to how it can provide a service which is or could be, in breach of its non-compete agreement with G Inc. The husband's evidence was that there is an assistance and anti-competition agreement between the two companies and, therefore, they will not be operating in competition with one another.
13. Rather unusually, the husband instructed his attorneys to send a letter to Mr RS (dated 19 May 2020³) seeking to persuade him that he need not in fact resign his position, citing –
 - (a) Mr RS is not currently employed by G Inc;
 - (b) G Inc is aware of Mr RS's directorship and has not suggested that there is a conflict;
 - (c) Mr RS will be contributing to both companies;
 - (d) Mr RS will continue as a shareholder; and
 - (e) Mr RS has demonstrated himself to be a reliable and effective director.

³ At page 244 of the hearing bundle

14. At this hearing Mr Cusworth QC reiterated that there is no evidence that Mr RS has acted or will act in breach of his fiduciary duty owed to Company U and that the wife's claim of conflict is misguided and may never arise. He argues that the wife's mistrust is at the centre of this application and that she fails to appreciate that the husband is working in the interest of all shareholders to improve the company's position. He describes the proposed removal of Mr RS as disproportionate and unnecessary and will substantially change the company which the husband may yet choose to buy-out the wife from.
15. Mr Todd proposes that the reason the husband is so keen to retain Mr RS as a director is that he is confident Mr RS will support the husband's plans for Company U, including the *ex gratia* payments and to keep the proceeds of the sale within Company U rather than disbursing them to the shareholders in the usual way.

ANALYSIS



16. The parties agree that were I to find that Mr RS should not continue as director that I have the power to make an *in personam* order that the husband vote in favour of, or not oppose, the wife's resolution to remove Mr RS and appoint an agreed, independent director. At common law every director has a fiduciary duty to act in good faith and in the best interests of the company. This is also enshrined in the company's Articles of Association.
17. This is the first time that the wife has had any concerns with Mr RS being a director. It is obvious to me that the wife's concerns arise, once more, from her mistrust of the husband and her firm belief that he intends to, or will cause her share of the business to be devalued, or that he seeks to withhold funds due to her under the judgment. She points to a number of issues which she asserts demonstrate that the husband intends to financially disadvantage her and prevent her from meeting her fiduciary duty as director of Company U –
- (a) Mr F refuses to provide the financials which the wife has requested;
 - (b) The husband is working towards expanding the business not a sale;

- (c) The husband is seeking to “strip out” large sums of money from the company by way of the *ex gratia* payments;
 - (d) The husband has unilaterally put the G Inc funds beyond the purview of the wife; and
 - (e) The wife has not been provided with details about the agreements in respect of particular gTLDs as she has requested.
18. The husband has provided reasons for the proposed *ex-gratia* payments. It is not for me to determine now whether those payments have sound, commercial basis, nor whether the company should be purchasing new gTLDs. These are matters for the board to determine in the ordinary way.
19. The issue of whether the parties are working towards a valuation of the business I must reserve to another day when the parties have the opportunity to speak to the matter more thoroughly.
20. I am not convinced that Mr F is intentionally withholding information from the wife, although I will abstain from commenting on the quality and manner of the reports being provided until I have heard full submissions, should the need arise.
21. My focus is on Mr RS’s ability to carry out his function as director to the necessary standard. While the wife suggests that the US\$ X proposed to be paid to Mr RS is some sort of reward for his evidence or for supporting the husband’s other motions, the reality is that Mr RS is bound to recuse himself from voting on this motion as this is a most obvious conflict. In turn, Mr RS probably by now also appreciates that the vote is likely to be split and that that particular motion will not pass. The reward element is therefore eliminated.
22. While the wife alleges that Mr RS was her husband’s ally at trial, it is worth noting that the wife did not challenge Mr RS’s evidence, and I also found that Mr RS’s evidence corroborated the wife’s account in an important aspect. I would characterise him as closer to a neutral witness.



23. The wife's fear that the husband is seeking to financial disadvantage her is contradicted by the favourable G Inc deal recently secured from which the wife has already benefitted substantially and will do so again when the second tranche of funds is disbursed. It also remains in the husband's best interest to keep the company prospering to realise his full benefit also; the parties' goals are in truth aligned. I reject the wife's argument that the husband has ill-intent.
24. I have not been persuaded by the wife's arguments or the evidence that Mr RS will act anything other than in accordance with his fiduciary duty as a director in the upcoming board meeting. Neither am I persuaded that, at present, there is an actual or potential conflict between Mr RS's duties to Company U and his future employer. I accept the evidence of the husband on this point. Mr RS is clearly live to the issue of conflict as a result of the wife's letter and the company's Articles of Association. I am also sure that Company U's attorneys are equally live to the issues and will advise accordingly should there be cause for concern. I am not persuaded that it is in the parties' or the company's interest at this time to order that the wife nominate a professional proxy either. There is no need for the court to intervene with the board of directors at this stage.
25. Consequently, I refuse the wife's application for the orders set out in paragraphs 2 and 3 of her summons. However, in order to ensure clarity of my judgment should it still be necessary, I make the orders and declarations sought in paragraphs 4 and 5. Additionally, reiterating the common law position, I make an order in terms of paragraph 6 of the wife's summons.
26. The issue of costs is reserved.



Hon Kirsty-Ann Gunn

Acting Judge of the Grand Court

