Kleanthous v Paphitis

Chancery Division | September 7, 2011 | [2012] B.C.C. 676

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Chancery Division

Newey J. :

September 7, 2011

H1. *Derivative claims—Permission to continue derivative claim—Directors—Directors' fiduciary duties—Conflict of interests—No conflict and no profit duties—Corporate opportunity not taken by company—Shareholder-director took opportunity via acquisition vehicle—Funding for acquisition vehicle provided for and liabilities guaranteed by company—Some other directors of company became director-shareholders of acquisition vehicle—Acquisition vehicle later sold for large profit—Potential breach of duty—Application for permission to continue derivative claim against directors for alleged breaches of duty—Strength of case—Limitation—Matters to be taken into account—Whether permission to continue derivative claim to be granted—Limitation Act 1980 ss.21(1), 32—Companies Act 2006 ss.261, 263, 994.*

H2.. This was an application by a minority shareholder in a company under s.261 of the Companies Act 2006 for permission to continue a derivative claim on behalf of the company and one of its subsidiaries for alleged breach of fiduciary duty against several directors of the company.

H3.. The company, "RGL", in 1998 had subsidiaries of which "RL" carried on a well-known stationery business and "Contessa" had a lingerie business. RGL's shareholders were the claimant, "K", with 15.5 per cent of the shares, "P" with 72.4 per cent and "C" with 12.1 per cent. RGL's board included P and C and three others. K was not a director and had entered into a shareholders' agreement in which he had undertaken that he would hold his shares for investment purposes only and would not participate in or influence the affairs of RGL or any of its subsidiaries. P appeared in a well-known television business programme and had a high public profile. According to P, he was approached by the majority shareholder of a struggling

Canadian-owned lingerie company, "La Senza", to acquire its shares in La Senza for just £1 subject to accepting the vendor's ongoing liabilities in respect of La Senza. He contended that the RGL board agreed that it would not be appropriate for RGL to acquire La Senza since the latter's parlous financial position might be detrimental to the group's financial position, but that he was interested in doing so in his personal capacity. He did so via a newly acquired shelf company, "Xunely" of which he became a director. At a board meeting of RGL in early June 1998, not attended by C and one of the other directors, at which the share acquisition was discussed, P asked the other directors attending whether they would agree to RGL lending Xunely the funds to acquire the remaining shares in La Senza and it was agreed that (a) a loan of up to £1.8 million should be made to Xunely to finance its acquisition of La Senza at an interest rate of 3 per cent above base rate and with security over Xunely's assets; (b) a guarantee should be given in respect of the La Senza's possible liability to the majority shareholder, and (c) a management agreement should be entered with Xunely for the provision of management services by RGL. The minutes recorded that the board members present confirmed that the matters were of commercial benefit to **677* RGL. That day the other three directors of RGL (apart from P and C) became directors of Xunely. Two of these were also granted share options in RGL and Xunely. Also that day Xunely agreed to buy the majority shareholder's shares in La Senza for £1 and to indemnify the vendor in respect of the guarantees given in relation to La Senza. RGL guaranteed Xunely's performance of these obligations. On June 15, 1998, one of the RGL directors confirmed that RGL would provide financial support to ensure that La Senza was able to continue trading and meet its commitments. On June 16, 1998, RGL formally offered to lend Xunely up to £1.8 million to enable it to make an offer for all the issued shares in La Senza not already owned by Xunely. The full acquisition by Xunely went through. In late 2001 Contessa was demerged from the RGL group, which thus no longer had an interest in the lingerie trade. Xunely declared dividends in favour of P of some £2.7 million in 2004 and £4 million in 2006. In 2006 Xunely sold 90 per cent of its shares in La Senza for more than £100 million.

H4.. On November 29, 2010, K issued proceedings claiming that the acquisition of La Senza by Xunely involved breaches of directors' fiduciary duty on the part of P, C and the two other directors of RGL with share options. As directors they owed fiduciary obligations to RGL and RL not to use company assets for their own benefit or for that of associated companies and not to divert business opportunities from RGL but from June 1998 onwards, they committed serious and fraudulent breaches of these fiduciary duties by diverting the substantial business opportunity of the purchase of La Senza for the benefit of P and his company Xunely, used the assets of RGL and/or RL for their own benefit by assisting Xunely in order to purchase La Senza and funded La Senza's activities after the acquisition, and they failed to disclose their own breaches of duty to K as an independent shareholder of RGL and/or RL. K alleged that by these breaches the defendants made substantial profits in excess of £120 million and caused enormous loss to RGL and RL. On the same day, K applied for permission under s.261 of the Companies Act 2006 to continue the proceedings as a derivative claim.

H5.. On February 17, 2011, the boards of RGL and RL each resolved to set up a committee consisting of two directors who joined the group subsequent the acquisition of La Senza to seek professional advice and make decisions in relation to the proceedings. The committees resolved that RGL and RL should not bring or continue the claim brought derivatively by K because the negative effect on the company's businesses of it continuing a claim against the defendant directors greatly outweighed any benefit to the company by pursuing the claim and bringing or continuing the claim against the defendant directors would not promote the success of the company.

H6.. Under s.261(2) of the 2006 Act if the application did not disclose a prima facie case for giving permission, the court must dismiss the application, and P submitted, amongst other things, that the court should grant permission for a derivative claim to be continued only if satisfied that the claimant had a strong case.

H7.. **Held,** dismissing the application:

H8.. 1. The court could potentially grant permission for a derivative claim to be continued without being satisfied that there was a strong case. The merits of the claim would be relevant to whether permission should be given, but there was no set threshold, for the legislation did not prescribe a particular standard of proof that has to be satisfied but rather required consideration of a range of factors by the court to reach an overall view. (*Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch); [2010] B.C.C. 420* and *Stainer v Lee [2010] EWHC 1539 (Ch); [2011] B.C.C. 134 applied* .)

H9.. 2. There was a strong case for saying that the "no conflict" and "no profit" rules were both potentially engaged in the instant case: the reasonable man might surely have taken that view in relation to Xunely's acquisition of La Senza. P arguably had conflicts of both interest and duty as Xunely's owner and one of its directors. Two of the other defendants could also be said to have had ***678*** conflicts of duty once they became directors of Xunely as well as of RGL. The way in which RGL facilitated Xunely's acquisition of La Senza pointed to the "no profit" rule applying as well. (*Bhullar v Bhullar [2003] EWCA Civ 424; [2003] B.C.C. 711 considered* .)

H10.. 3. However two of the defendant directors did not acquire significant financial interests in La Senza until several years after the main events above and C, who was never a shareholder

or director of Xunely, never had any obvious reason to act otherwise than in the interests of the RGL and RL. The board minutes confirmed that the director defendants had the interests of the RGL and RL in mind in June 1998 and the director defendants had put forward a number of reasons for not wanting RGL to acquire La Senza but for being prepared to support Xunely's acquisition of it. Further, it was arguable that the claims were statute barred in the absence of fraud or concealment under the Limitation Act 1980 ss.21(1) and 32 . Thus although there were arguable claims against the director defendants the chances of the claims succeeding were significantly less than evens and the claim against C, who had not received any profits for which he could be liable to account, was particularly weak.

H11.. 4. In relation to permission to continue the derivative claim, the claim against C was particularly weak as he had not received any profits for which he could be liable to account, so that under s.263(2)(a) of the Companies Act 2006 no director acting in accordance with s.172 (duty to promote success of the company) would seek to continue the claim against him and permission to continue it in relation to C must be refused.

H12.. 5. The claim against P and the other two directors was not of such strength and size (even in the case of P) as could make it appropriate to grant permission when: (a) applying s.263(3)(e) and (4) , that course was strongly opposed, on a reasoned basis, by RGL and RL's independent committees who had taken professional advice as well as by C, and in considering the importance that a person acting in accordance with s.172 would attach to continuing the claim under s.263(3)(b) it was relevant that continuation would damage RL's reputation and lead to deterioration in RGL's performance and value; (b) applying s.263(3)(f) it was open to K to seek redress by means of an application under s.994 of the 2006 Act and the availability of an alternative remedy in the form of an unfair prejudice petition was a powerful reason to refuse permission for the derivative claim to proceed in this case, especially in the suspicion that K chose to pursue derivative proceedings alone in the hope that that he would be able to obtain a costs indemnity (*Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Ch); [2008] B.C.C. 885* and *Iesini v Westrip Holdings Ltd (above) applied*); and (c) much of any money recovered from the director defendants to RGL could be expected to be returned to them by way of distribution as shareholders in RGL anyway. In fact these factors would have caused the court to hesitate to grant permission even if persuaded that the proposed claim was a strong one.

H13. Cases referred to:

AIC Ltd v ITS Testing Services (UK) Ltd (The Kriti Palm) [2006] EWCA Civ 1601; [2007] 2 C.L.C. 223

Alsop Wilkinson v Neary [1996] 1 W.L.R. 1220
Beddoe, Re; Downes v Cottam [1893] 1 Ch. 547)
Bhullar v Bhullar [2003] EWCA Civ 424; [2003] B.C.C. 711
Chan (Kak Loui) v Zacharia (1986) 154 C.L.R. 178
Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Ch); [2008] B.C.C. 885
Gwembe Valley Development Co Ltd v Koshy (No.3) [2003] EWCA Civ 1048; [2004] 1 B.C.L.C. 131
Halton International Inc (Holdings) v Guernroy Ltd [2006] EWCA Civ 801 ****679***
Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch); [2010] B.C.C. 420
J D Wetherspoon Plc v Van De Berg & Co Ltd [2007] EWHC 1044 (Ch); [2007] P.N.L.R. 28
Johnson v Chief Constable of Surrey, The Times, November 23, 1992
Movitex v Bulfield (1986) 2 B.C.C. 99403
Paragon Finance Plc v D B Thakerar & Co [1999] 1 All E.R. 400
Regentcrest Plc (in liq.) v Cohen [2001] B.C.C. 494
Stainer v Lee [2010] EWHC 1539 (Ch); [2011] B.C.C. 134
STG Valmet Trustees Ltd v Brennan (2001–02) 4 I.T.E.L.R. 337
Wishart v Castlecroft Securities Ltd [2009] CSIH 65; [2010] B.C.C. 161

H14. **Representation**

Richard Keen QC and Andrew Hunter (instructed by Jones Day) for the claimant
Neil Kitchener QC and Sam O'Leary (instructed by Mishcon de Reya) for the first defendant
Richard Snowden QC and Ben Shaw (instructed by Reed Smith LLP) for the second, third, and fourth defendants.
Michael Todd QC and Mary Stokes (instructed by Ashurst LLP) for the fifth and sixth defendants.

JUDGMENT

NEWEY J.

1. The claimant, Mr Kleanthous, is a shareholder in Ryman Group Ltd ("RGL"), the fifth defendant. By the application before me, he seeks permission under s.261 of the Companies Act 2006 to continue a derivative claim on behalf of RGL and one of its subsidiaries, Ryman Ltd ("RL"), which is the sixth defendant.

2. The claim which Mr Kleanthous wishes to pursue arises out of the acquisition by Xunely Ltd ("Xunely") of La Senza Plc ("La Senza") in 1998. Xunely's owner, Mr Paphitis (the first defendant), was (and is) also a director of RGL and the company's principal shareholder. In the present proceedings, Mr Kleanthous alleges that the acquisition of La Senza involved breaches of fiduciary duty on the part of Mr Paphitis and three other directors of RGL: the second, third,

and fourth defendants, respectively Mr Cooke, Mr Towner and Mr Childs. I shall refer to Messrs Paphitis, Cooke, Towner and Childs collectively as "the director defendants".

Basic facts

3. In 1998, RGL, which was then called "Chancerealm Ltd", had three subsidiaries. One of these, RL, carried on a well-known stationery business. A second subsidiary, Contessa (Ladieswear) Ltd ("Contessa"), had a lingerie business. The third subsidiary, NAG Communications Ltd, had a mobile telephone business.

4. RGL's shareholders were Mr Kleanthous, Mr Paphitis and Mr Childs. Mr Paphitis was much the largest shareholder, with 72.4 per cent of the shares. Mr Kleanthous and Mr Childs respectively held 15.5 per cent and 12.1 per cent of the shares.

5. RGL's board included two of its three shareholders: Mr Paphitis and Mr Childs. The other members of the board were Mr Cooke, Mr Towner and a Mr Ring. Mr Kleanthous was not a director. He had entered into a shareholders' agreement in 1996 under which he had undertaken that he would hold his shares for investment purposes only and would not: ***680**

> "… participate in or influence the affairs of [RGL] or any of its subsidiaries or seek or be entitled to any information in respect of the day-to-day management of [RGL] other than information available to all shareholders as prescribed by law."

6. Mr Paphitis is one of the "dragons" on the well-known television programme "Dragons' Den" and has a high public profile. Mr Childs has a background in marketing and was co-founder with Mr Paphitis of Movie and Media Sports Ltd, a business which, Mr Childs says, occupied most of his time in 1998. For his part, Mr Cooke has many years' experience of senior management, especially in retail; he was a director of RL before Mr Paphitis became involved with it. Mr Towner is a solicitor and was a partner in Richards Butler (later to be incorporated into Reed Smith) until he retired in 1992; he is a non-executive director of RGL and RL ("the Ryman companies"). In 1998, Mr Cooke and Mr Towner each had share options in RGL.

7. At the beginning of 1998, Suzy Shier, a retailer in Canada and the United States, owned through Suzy Shier Equities Inc, a wholly-owned subsidiary of Suzy Shier Ltd, 60.2 per cent

of the issued share capital of La Senza. La Senza carried on a lingerie business and was listed on the London Stock Exchange's AIM market.

8. By early 1998, Suzy Shier was looking for buyers for its shareholding in La Senza. According to Mr Paphitis, he was approached about La Senza in February or March of 1998 and subsequently discussed with other directors of RGL the possibility of becoming involved with La Senza. Both Mr Paphitis and the other director defendants say that it was decided that it would not be appropriate for RGL to acquire La Senza.

9. Mr Paphitis says that he was approached about La Senza again at the beginning of June 1998. On this occasion, Mr Paphitis explains, Suzy Shier offered to sell its shares in La Senza for just £1 subject to the provision of an indemnity in respect of certain ongoing liabilities of La Senza, which largely related to equipment leases. According to Mr Paphitis, he and his fellow directors remained of the view that RGL should not undertake the acquisition, but he decided (with the blessing of other directors) that he would like to take on La Senza in a personal capacity. The evidence of the other director defendants is to broadly similar effect.

10. Matters came to a head during the night of June 3–4, 1998, during which there were negotiations which ultimately led to Mr Paphitis agreeing to buy Suzy Shier's shares in La Senza through Xunely, a newly-acquired shelf company. In the course of these negotiations, Mr Paphitis asked Mr Cooke, Mr Towner and Mr Ring whether they would agree to RGL lending Xunely the funds (some £1.4 million) required to buy the shares in La Senza held by shareholders other than Suzy Shier (Suzy Shier having apparently called for proof of Mr Paphitis' ability to fund the purchase of these shares) and giving a guarantee in respect of Suzy Shier's exposure to liabilities of La Senza (Suzy Shier having apparently stated that a third-party guarantee was required).

11. In Mr Cooke's words, "[a] board meeting was convened between those directors [of RGL] present in the meeting room at Gouldens' offices". Mr Towner wrote out minutes of this meeting in manuscript. These recorded that Mr Paphitis, Mr Cooke and Mr Towner were present and that Mr Ring, who was "unavoidably absent but had participated in negotiations", was in agreement. The minutes stated that it had been resolved that:

(i) a loan of up to £1.8 million should be made to Xunely to finance its acquisition of La Senza at an interest rate of 3 per cent above base rate and with security over Xunely's assets;
(ii) a guarantee should be given in respect of "the possible liability of La Senza to Suzy Shier Limited on terms to be agreed by the Board";

(iii) a management agreement should be entered with Xunely on terms to be agreed. *681

The minutes went on to record that the board members present "confirmed that in their opinion the matters, having been discussed in detail, were of commercial benefit to [RGL]". However, in the course of submissions Mr Neil Kitchener QC, who appears with Mr Sam O'Leary for Mr Paphitis, accepted that Mr Childs had not been given notice of the June 3 "board" meeting and so that it could not have constituted a valid board meeting.

12. It seems that it was also that evening that Mr Cooke and Mr Towner became directors of Xunely, as did Mr Ring. Mr Cooke and Mr Towner were later to acquire share options in Xunely, but not, it seems, until late 2001. Thereafter, Mr Cooke and Mr Towner respectively had share options of 7.62 per cent and 3.55 per cent in RGL and 7.5 per cent and 2.55 per cent in Xunely. Mr Childs has never held shares or share options in Xunely nor been a director of the company.

13. On June 4, 1998, an agreement was entered into under which, among other things, Xunely agreed (a) to buy Suzy Shier Equities Inc's shares in La Senza for £1, and (b) to indemnify Suzy Shier companies in respect of guarantees they had given in relation to La Senza. Further, RGL covenanted that it would procure that Xunely performed its obligations under the agreement and, in particular, would pay Suzy Shier any sums which Xunely failed to pay.

14. Mr Childs says that he recalls being told by Mr Paphitis during the morning of June 4, 1998, that he had bought La Senza. Mr Paphitis says that he told Mr Childs that day that Mr Cooke, Mr Towner and Mr Ring had accepted appointments as directors of Xunely.

15. In the following days, there were press reports about Xunely's acquisition of La Senza. The Independent , for example, reported on June 5, 1998, that:

> "Suzy Sher Equities [had] sold its 60 per cent controlling stake for a token pounds 1 to Xunely, a newly created company controlled by Theo Paphitis and his family, the owners of Rymans the stationers and Contessa Ladieswear."

The Financial Times referred in an article dated June 18, 1998, to "Financial support from a company associated with its prospective new owner" having enabled La Senza to continue trading.

16. On June 15, 1998, there was a board meeting of RGL. This was attended by Mr Paphitis, Mr Cooke, Mr Childs and Mr Ring. The minutes contained the following account of events:

> "The Chairman [i.e. Mr Paphitis] confirmed that he had discussed with members of the Board the possible acquisition of La Senza by Chancerealm [i.e. RGL] but a decision had been reached that, in view of the extremely parlous financial situation of La Senza it would not be sensible to acquire that company and bring it with[in] the Chancerealm group. Whilst Mr Paphitis, having discussed a number of issues relating to that acquisition with Mr Ring and Mr Cooke, was confident that the situation could be turned round, if the financial figures of La Senza were incorporated in the Chancerealm Group profits at this time it would have a damaging effect on the Chancerealm Group profits notwithstanding that the shareholders' value in the Group is represented by the trading performance of each individual subsidiary. However in order to ensure that no reduction in Group profits (and hence perception of the Group's performance) occurred as a result of the introduction of La Senza into the Group it had been agreed that a special purpose company, owned by Mr Paphitis, should acquire the La Senza shares. However the activities of La Senza and its product, and outlets would be complementary to the products and outlets of Contessa (Ladieswear) Limited and benefits would accrue to the Chancerealm Group by the provision of management and administrative services (on an arm's length basis for which it would be properly remunerated) by La Senza and by the utilisation of surplus warehouse and office space at Hayes by La Senza (again for which La Senza would pay an arm's length fee). ***682**
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> The association would also result in increased buying power and probable resultant discounts and purchasing terms from suppliers, reduced overheads (because of shared facilities deliveries to outlets and so on) and for the relevant services it was proposed that La Senza would pay on an arm's length basis."

After recording that the board "had considered that it was in the interests of the company to enter into the arrangements relating to the loan and to the provision of the guarantee", the minutes stated:

> "All those present confirmed their agreement with the above matters and it was noted that Richard Towner, who had expressed apologies for his absence from the meeting, had been present at the Board meeting held on 3rd June and had agreed with the various matters therein dealt with. Furthermore discussions had taken place between the Chairman, Mr Ring and Richard Towner with regard to the various issues now discussed at this Board Meeting and Mr Towner had expressed his agreement with them."

The minutes proceeded to record, among other things, that a form of loan agreement had been approved. They also stated:

> "It was noted that in order to enable the auditors to La Senza Plc to sign off the Accounts for the year ended 31st January 1998, the Company had provided a letter confirming the discussions held with the Directors and advisers of La Senza Plc on 3rd June 1998 that the Company would provide or procure such financial support as is reasonable and necessary to enable La Senza Plc to continue trading."

17. Also on June 15, 1998, Mr Ring wrote on behalf of RGL to confirm that it would "procure or provide such financial support as is necessary and reasonable to ensure that La Senza plc is able to continue trading and meet its commitments as they fall due". On June 16, RGL formally offered to lend Xunely up to £1.8 million to enable it to make an offer for all the issued shares in La Senza not already owned by Xunely.

18. Minutes of a further board meeting of RGL, on June 23, 1998, recorded agreement to provide United Mizrahi Bank Ltd with a guarantee, limited to £2 million, which the bank required in support of a trade finance facility provided to La Senza.

19. There was reference to arrangements between Xunely and RGL in a circular distributed in the second half of June 1998 to shareholders of La Senza (who, however, did not include Mr Kleanthous). In particular, a letter included in the circular had a passage in these terms:

> "Xunely has entered into an agreement with Chancerealm [i.e. RGL] whereby Chancerealm has committed to lend to Xunely up to £1.8 million for the purpose of financing the Offer … Furthermore, Chancerealm has guaranteed the performance by Xunely of the indemnity given by Xunely to Suzy Shier referred to above. It is proposed that Xunely and La Senza will enter into a management agreement with Chancerealm whereby Chancerealm will provide management services for the operation of the La Senza business."

The letter identified Mr Paphitis, Mr Cooke, Mr Towner and Mr Ring as directors of both Xunely and RGL.

20. Mr Kleanthous evidently saw some of the press coverage relating to the sale of La Senza. In a letter to Mr Towner dated August 11, 1998, he said: ***683**

> "A short while ago I spoke with Theo [Paphitis] regarding press reference to the purchase of the La Senza Canadian Lingerie chain. I would appreciate any information you are able to provide on how this purchase effects the strategy of the Chancerealm [i.e. RGL] Group."

Replying on the following day, Mr Towner said:

> "So far as concerns La Senza, the purchase was by Xunely Limited, a company wholly owned by Theo and I think that any queries as to how this relates to or affects the strategy of the Chancerealm Group were best directed at Theo."

Two days later, Mr Kleanthous wrote to Mr Paphitis enclosing a copy of Mr Towner's letter. In his letter, Mr Kleanthous said:

> "Regarding his second paragraph [i.e. the passage from Mr Towner's letter quoted above], I should be interested in your comments. When I first learned about the purchase of La Senza a few months ago, I had assumed it was a Chancerealm deal since presumably La Senza is a similar line of business to Contessa."

Responding on August 17, Mr Paphitis said this:

> "Further to your letter dated 14 August 1998, I am somewhat surprised with the second paragraph since you and I have had 2 telephone conversations subsequent to the purchase of La Senza. At the time of the calls, I made the situation absolutely clear and explained to you that this was not purchased by Chancerealm Ltd and it was not a Chancerealm deal which you fully understood and accepted.
>
> I am not going to labour on in order to remind you word for word about the conversation, or get involved in any lengthy correspondence to this end, but as always it will be a pleasure to get together with you should you wish, and answer any questions which you may have with regards to Chancerealm or La Senza face to face."

21. Mr Kleanthous wrote back to Mr Paphitis on August 27, 1998. His letter included these paragraphs:

> "After I read the press comment about the purchase of La Senza, I did raise the matter with you and, while I understood what you told me, it is not correct to say that I accepted the situation.

> Indeed, given the similarity of this business with that of Contessa, I was keen to establish how you would propose to deal with the apparent conflict of interest."

Mr Paphitis does not appear to have replied. Neither does Mr Kleanthous seem to have pursued Mr Paphitis' suggestion of a face-to-face meeting.

22. The Ryman companies' accounts for the year ended March 27, 1999, which were filed at Companies House in April 2000, contained references to the companies' support for Xunely and La Senza. The note to RGL's accounts dealing with related party transactions explained that the figure given for "other debtors" of RGL included "£1,398,076 owed by La Senza Limited, this balance having arisen as a result of cash transfers having been made to La Senza Limited" and "£146,338 owed by Xunely Limited … as a result of the payment of professional fees on behalf of Xunely Limited". It was further explained that the figure given for "other debtors" of the group included £1,443,340 owed by Xunely "as a result of the payment of professional fees on behalf of Xunely Limited and as a result of cash transfers to Xunely Limited". There was reference, too, to the group having "made a management charge of £625,000 to La Senza Limited to cover warehouse, transport ***684*** and other associated costs borne by the group on behalf of La Senza Limited". Another note stated that RGL "guarantees the trade finance facility of La Senza".

23. In late 2001, Contessa was de-merged. Contessa was, as I understand it, transferred to a new holding company whose shareholdings corresponded to RGL's. Mr Cooke explains in his witness statement that it was thought sensible for RGL to focus exclusively on stationery. At this stage, Mr Kleanthous through his then solicitor acknowledged that there had been no breach of duty by RGL's directors "as far as he [was] aware".

24. In similar vein, in 2002 Mr Kleanthous countersigned a letter to confirm that, so far as he was aware, he had no claim against his fellow shareholders or directors "suggesting any breach of fiduciary obligations or anything improper in the operations of any of [the companies in the RGL and La Senza groups]".

25. Xunely declared dividends in favour of Mr Paphitis of some £2.7 million in 2004 and £4 million in 2006.

26. In 2006, Xunely sold 90 per cent of its shares in La Senza to a private equity group called Lion Capital for more than £100 million.

27. Later in 2006, Contessa was also sold to Lion Capital. According to Mr Kleanthous, the price to be paid was over £8 million but was to be reduced to about £5.5 million after deduction of a debt owed to RGL. Following its sale, 47 of Contessa's shops seem to have become La Senza shops while the remaining 18 were apparently closed.

28. In a letter dated February 26, 2010, Mr Kleanthous' solicitors informed Mr Paphitis and the directors of the Ryman companies that Mr Kleanthous was proposing to bring a claim by way of derivative action against Mr Paphitis, RGL and RL. At this stage, it was not suggested that the proposed claim would extend to Mr Cooke, Mr Towner or Mr Childs. It was, however, said that Mr Cooke, Mr Towner and Mr Childs were "not independent" and that "it should have been apparent to them that the conduct of Mr Paphitis was wrongful". Subsequently, after correspondence with solicitors instructed on behalf of, respectively, Mr Paphitis and the other directors of RGL and RL, Mr Kleanthous widened the ambit of the proposed derivative claim to encompass allegations against Mr Cooke, Mr Towner and Mr Childs.

29. The proceedings which are now before me were issued on November 29, 2010. On the same day, Mr Kleanthous applied for permission under s.261 of the Companies Act 2006 to continue his derivative claim. On December 21, 2010, Floyd J. gave directions in relation to the application to continue the derivative claim. The directions provided, among other things, for the various defendants to be made respondents to Mr Kleanthous' application and for the defendants to file and serve evidence in answer to it.

30. The board of RGL now comprises Mr Paphitis, Mr Cooke, Mr Towner, Mr Childs, Mr Kypros Kyprianou ("Mr Kyprianou") and Mr Simon Lakin ("Mr Lakin"). Mr Kyprianou joined the RGL group in 2004. Mr Lakin became a director of RGL in 2008, having previously been an employee since 2001.

31. On February 17, 2011, the boards of RGL and RL each resolved to set up a committee, to consist of Mr Kyprianou and Mr Lakin, to seek professional advice and make decisions in relation to the present proceedings. On March 3, the committees resolved that RGL and RL

should not bring or continue the claim brought derivatively by Mr Kleanthous. The minutes of each meeting included this:

"After careful consideration the directors concluded that: ***685**

(a) the negative effect on the Company's businesses of the Company bringing or continuing a claim against the defendant directors greatly outweighs any benefit to the Company by pursuing the claim; and
(b) bringing or continuing the claim against the defendant Directors would not promote the success of the Company."

32. Mr Kleanthous' case is summarised as follows in the Particulars of Claim:

"In summary, as set out in more detail below:

9.1 As directors of RGL and Ryman [i.e. RL], the Director defendants owed fiduciary obligations to RGL and Ryman, which amongst other things required them not to use company assets for their own benefit or for that of associated companies and not to divert business opportunities from RGL or Ryman.
9.2 From about June 1998 onwards, the Director defendants committed serious and fraudulent breaches of these fiduciary duties:

9.2.1 the Director defendants diverted a substantial business opportunity (namely the purchase of the company and lingerie business, La Senza) away from RGL and Ryman in order to develop this opportunity for the benefit of Pahitis and his company Xunely (in which Cooke and Towner were also interested);
9.2.2 the Director defendants used the assets of RGL and/or Ryman for their own benefit and/or that of Paphitis' company, Xunely, by procuring RGL and/or Ryman: (1) to make loans to Xunely in order to purchase La Senza; (2) to fund La Senza's activities after the acquisition, and (3) to provide a trade finance facility for La Senza;
9.2.3 the Director defendants failed to disclose their own breaches of duty to the independent shareholder of RGL and/or Ryman, namely AK.

9.3 Paphitis (acting on his own behalf and for Cooke, Towner and Childs) deliberately concealed the wrongful conduct and breaches of duty from AK [i.e. Mr Kleanthous], being the independent shareholder of RGL and Ryman.
9.4 By reason of the said matters, the Director defendants have made very substantial profits (in excess of £120 million) and have caused enormous loss to RGL and Ryman.
9.5 RGL and Ryman remain under the control of the Director defendants who have refused to permit these companies to commence proceedings in respect of the wrongdoing committed by them.

9.6 By reason of the matters aforesaid, it is appropriate for this claim to be brought as a derivative action. RGL and Ryman are entitled to remedies against the Director defendants including declarations of trust and/or an account of profits or equitable compensation."

33. Mr Kleanthous now asks, first, for permission to continue the claim on behalf of RGL and RL and, secondly, to be indemnified by RGL and RL in respect of costs. The defendants all oppose the grant of any such relief.

The legal framework

Part 11 of the Companies Act 2006

34. The circumstances in which a derivative claim can be brought are nowadays dealt with in Pt 11 of the Companies Act 2006 . As regards England and Wales, the relevant provisions are ss.260–264 . ***686**

35. Section 261(1) of the 2006 Act stipulates that a member of a company who brings a derivative claim must apply to the court for permission to continue it. If it appears to the court that the application and the evidence filed in support of it do not disclose a prima facie case for giving permission, the court must dismiss the application (s.261(2)). If, on the other hand, the application is not dismissed at this stage, the court may "give directions as to the evidence to be provided by the company" and adjourn the application to enable the evidence to be obtained (s.261(3)). On hearing the application, the court may (under s.261(4)):

"(a) give permission … to continue the claim on such terms as it thinks fit,
(b) refuse permission … and dismiss the claim, or
(c) adjourn the proceedings on the application and give such directions as it thinks fit."

36. Section 263 is concerned with when permission to continue a derivative claim should be given. Sub-sections (2), (3) and (4) are in the following terms:

(2). "Permission (or leave) must be refused if the court is satisfied–

(a) that a person acting in accordance with section 172 (duty to promote the success of the company) would not seek to continue the claim, or
(b) where the cause of action arises from an act or omission that is yet to occur, that the act or omission has been authorised by the company, or

(c) where the cause of action arises from an act or omission that has already occurred, that the act or omission–

(i) was authorised by the company before it occurred, or
(ii) has been ratified by the company since it occurred.

(3). In considering whether to give permission (or leave) the court must take into account, in particular–

(a) whether the member is acting in good faith in seeking to continue the claim;
(b) the importance that a person acting in accordance with section 172 (duty to promote the success of the company) would attach to continuing it;
(c) where the cause of action results from an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be–

(i) authorised by the company before it occurs, or
(ii) ratified by the company after it occurs;

(d) where the cause of action arises from an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company;
(e) whether the company has decided not to pursue the claim;
(f) whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than on behalf of the company.

(4). In considering whether to give permission (or leave) the court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter."

37. Section 172 of the 2006 Act, to which there is reference in s.263 , requires a director to act "in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole". In doing so, he is to have regard (amongst other matters) to: ***687**

"(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others,
(d) the impact of the company's operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between members of the company."

Section 263(2)(a)

38. Section 263(2)(a) of the 2006 Act will not apply merely because some, or even most, directors would not seek to continue the claim. In *Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch); [2010] B.C.C. 420* , Lewison J. explained the position as follows (in [86]):

> "[Section] 263(2)(a) will apply only where the court is satisfied that *no* director acting in accordance with s.172 would seek to continue the claim. If some directors would, and others would not, seek to continue the claim the case is one for the application of s.263(3)(b)."

No threshold

39. Mr Kitchener submitted that the court should grant permission for a derivative claim to be continued only if satisfied that the claimant has a strong case. In this connection, he relied on a passage from *Iesini v Westrip Holdings Ltd (above)* . In [79] of his judgment in that case, Lewison J. suggested that, for the court to give permission for a derivative claim to be continued under s.261(4) , "something more than a prima facie case" is required.

40. However, Pt 11 of the 2006 Act does not in terms provide that a claim must reach a specific threshold if it is to be allowed to continue. Further, in *Stainer v Lee [2010] EWHC 1539 (Ch); [2011] B.C.C. 134* , Roth J. expressed the view (in [29]) that s.263(3) and (4) "do not prescribe a particular standard of proof that has to be satisfied but rather require consideration of a range of factors to reach an overall view". Roth J. went on:

> "In particular, under s.263(3)(b), as regards the hypothetical director acting in accordance with the s.172 duty, if the case seems very strong, it may be appropriate to continue it even if the likely level of recovery is not so large, since such a claim stands a good chance of provoking an early settlement or may indeed qualify for summary judgment. On the other hand, it may be in the interests of the company to continue even a less strong case if the amount of potential recovery is very large. The necessary evaluation, conducted on, as Lewison J. observed, a provisional basis and at a very early stage of the proceedings, is therefore not mechanistic."

41. Roth J.'s observations are consistent with the Law Commission's intentions. In para.6.72 of its report on *Shareholder Remedies* (Law Com No.246, 1997, Cm 3769), on which the relevant provisions of the 2006 Act are to a considerable extent based, the Law Commission recommended that "there should be no threshold test on the merits". Roth J.'s views are in keeping, too, with comments made in a Scottish case, *Wishart v Castlecroft Securities Ltd [2009] CSIH 65; [2010] B.C.C. 161* . Lord Reed, giving the opinion of the Inner House, there said (in [40]):

> "[S]ection 268 [i.e. the Scottish equivalent to s.263] does not impose any threshold test in relation to the merits of the derivative proceedings. As we have explained, the Law Commission ***688*** recommended that there should be no such test, partly in order to avoid the risk of a detailed investigation into the merits of the case taking place at the leave stage, and partly to avoid the drawing of fine distinctions based on the language of a particular rule. Section 268, and the parallel provision for England and Wales and Northern Ireland in s.263, do not depart from that recommendation. That is consistent with the nature of the factor to be considered under s.268(2)(b): it is possible to conceive of circumstances in which a director acting in accordance with s.172 might attach great importance to raising proceedings which were merely arguable, and of other circumstances in which a director might have sound business reasons for attaching little importance to raising proceedings which had good prospects of success."

42. In the circumstances, it seems to me that the court can potentially grant permission for a derivative claim to be continued without being satisfied that there is a strong case. The merits of the claim will be relevant to whether permission should be given, but there is no set threshold.

The role of the director defendants

43. When opening the matter, Mr Richard Keen QC, who appears with Mr Andrew Hunter for Mr Kleanthous, queried what role the director defendants should be playing in the application. He pointed out that in *Wishart v Castlecroft Securities Ltd (above)* the Inner House considered that directors against whom it was proposed that derivative proceedings be brought should not be allowed to take part in the application to continue the claim (see [26] of the opinion of the court). The court's reasons for arriving at that conclusion included, first, that the directors had "no interest in the proceedings as individuals (other than in the most general sense), by reason of being intended defenders in the derivative proceedings" ([19]); secondly, that, while the 2006 Act provides for evidence from the company, there "is no indication in s.266 that the proposed defenders are intended to participate in the proceedings on the application" ([20]); thirdly, that there "is nothing in the matters to be considered which suggests that it should ordinarily be necessary to hear the proposed defenders" ([20]); and fourthly, that it "is not in the interest of the company … that the potential defenders in those proceedings should be given advance notice of weaknesses in the company's case and of documents and witnesses which would be helpful to their defence" ([23]). Section 266 of the 2006 Act, which is concerned with derivative proceedings in Scotland, largely corresponds to s.261 of the Act.

44. Mr Keen did not go so far as to suggest that I should refuse to hear counsel for the director defendants. In any case, I consider that the director defendants were entitled to advance submissions to me. That must, I think, follow from the order made by Floyd J. on December 21, 2010, which provided for the director defendants to be made respondents to the application for permission to continue the derivative claim and to put in evidence in answer to the application. It seems to me, moreover, that it was appropriate for the director defendants to be permitted to

participate in the permission application. In the first place, s.261 of the 2006 is not identical to s.266 . In particular, while s.266 states that "the company is entitled to take part in the further proceedings on the application", s.261 says nothing about who is entitled to take part in the permission application. More importantly perhaps, where (as in the present case) the claimant is seeking an indemnity as to costs, a defendant who is a shareholder will have an interest other than merely as a person against whom it is intended that proceedings are brought. On the facts of the present case, an indemnity would be likely to mean that the director defendants stood, in practice, to bear the bulk of Mr Kleanthous' costs even if his claim were wholly unsuccessful. Further, while (as Mr Keen pointed out) proposed defendants can be expected to be partisan, so can the claimant. A claimant will be in a very different position to that of, say, trustees seeking a *Beddoe* order (*Re Beddoe; Downes v Cottam [1893] 1 Ch. 547*), ***689** on whom it is incumbent to "make full disclosure of the strengths and weaknesses of their case" (see *Alsop Wilkinson v Neary [1996] 1 W.L.R. 1220* , at 1224). That leads to another point. A court hearing a *Beddoe* application will commonly need to have access to privileged material. In contrast, there will normally be no question of a court dealing with an application to continue derivative proceedings being offered access to privileged material, and there was no suggestion in the present case that I needed to see such material; participation in the permission application will not, therefore, have given the director defendants access to material which they could not otherwise have seen. It is also relevant to note that the modern tendency is to allow those with whom trustees are in litigation to participate as fully as possible in *Beddoe* applications. Thus, in *STG Valmet Trustees Ltd v Brennan (2001–02) 4 I.T.E.L.R. 337* , the Court of Appeal for Gibraltar said (at 351):

> "… claimants to the trust fund, whether they be beneficiaries or strangers to the trust, should be allowed the maximum opportunity of being heard on the application consistent with the need to maintain confidentiality on matters which properly arise for consideration between the trustee and the court alone."

The merits of the proposed claim

45. The merits of the proposed claim are of obvious relevance to the matters I have to decide. They have a bearing, in particular, on the factors specified in s.263(2)(a) and s.263(3)(b) of the 2006 Act. As Lewison J. said in *Iesini v Westrip Holdings Ltd* (in [79]), any view as to the strength of a claim "can only be provisional where the action has yet to be tried; but the court must … do the best it can on the material before it".

46. Argument about the merits of the claim ranged widely. I do not think I need rehearse all the points that were aired before me, but I shall sketch out some of the main issues.

47. Company directors, like other fiduciaries, are subject to "no conflict" and "no profit" rules. The effect of these was summarised in these terms by Deane J. in the High Court of Australia in *Chan (Kak Loui) v Zacharia (1986) 154 C.L.R. 178* :

> "Stated comprehensively in terms of the liability to account, the principle of equity is that a person who is under a fiduciary obligation must account to the person to whom the obligation is owed for any benefit or gain (i) which has been obtained or received in circumstances where a conflict or significant possibility of conflict existed between his fiduciary duty and his personal interest in the pursuit or possible receipt of such a benefit or gain or (ii) which was obtained or received by use or by reason of his fiduciary position or of opportunity or knowledge resulting from it."

48. In the present case, there is a strong case for saying that the "no conflict" and "no profit" rules were both potentially engaged. The decision of the Court of Appeal in *Bhullar v Bhullar [2003] EWCA Civ 424; [2003] B.C.C. 711* suggests that the "no conflict" rule is capable of applying if "the reasonable man, looking at the relevant facts and circumstances of the particular case, would think that there was a real sensible possibility of conflict", and the reasonable man might surely have taken that view in relation to Xunely's acquisition of La Senza. Mr Paphitis arguably had conflicts of both interest and duty as Xunely's owner and one of its directors. Mr Cooke and Towner can also be said to have had conflicts of duty once they had become directors of Xunely as well as of the Ryman companies. The way in which the Ryman companies facilitated Xunely's acquisition of La Senza points to the "no profit" rule applying as well. ***690**

49. One of the answers advanced by the defendants is that the transaction was approved by RGL's board (in particular, at the board meeting on June 15, 1998). The defendants rely in this context on RGL's articles of association, art.22 of which, at the relevant times in 1998, provided as follows:

> "A director may vote as a director in regard to any contract or arrangement in which he is interested or upon any matter arising thereout, and if he shall so vote his vote shall be counted and he shall be reckoned in estimating a quorum when any such contract or arrangement is under consideration and Regulations 94 to 97 in Table A [i.e. Table A in the Companies (Tables A to F) Regulations 1985 (SI 1985/805)] shall be modified accordingly."

Further, reg.85 of Table A, which applied to RGL, was in the following terms:

> "Subject to the provisions of the Act [i.e. the Companies Act 1985], and provided that he has disclosed to the directors the nature and extent of any material interest of his, a director notwithstanding his office–
>
> (a) may be a party to, or otherwise interested in, any transaction or arrangement with the company or in which the company is otherwise interested;
> (b) may be a director or other officer of, or employed by, or a party to any transaction or arrangement with, or otherwise interested in, any body corporate promoted by the company or in which the company is otherwise interested; and
> (c) shall not, by reason of his office, be accountable to the company for any benefit which he derives from any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate and no such transaction or arrangement shall be liable to be avoided on the ground of any such interest or benefit."

50. There may be some scope for argument as to whether the director defendants sufficiently disclosed their conflicts of interest/duty to RGL's board. The minutes of the June 15, 1998 board meeting referred in terms to Mr Paphitis' ownership of Xunely, but nothing was said about the fact that Mr Cooke and Mr Towner had become directors of Xunely. Mr Paphitis has said in a witness statement that he told Mr Childs on June 4, 1998, that Mr Cooke, Mr Towner and Mr Ring had accepted appointments as directors of Xunely, but, even if that is right, it could be argued that one of the "provisions of the Act" had not been complied with and, hence, that the requirements of reg.85 of Table A could not be satisfied as regards Mr Cooke and Mr Towner. The provision in question would be s.317 of the Companies Act 1985 , which stipulated that a director of a company with an interest in a contract or proposed contract with the company had "to declare the nature of his interest at a meeting of the directors of the company". In the present case, Mr Cooke and Mr Towner do not appear to have declared their directorships of Xunely at a meeting of RGL's board. On the other hand, Mr Richard Snowden QC, who appears with Mr Ben Shaw for Mr Cooke, Mr Towner and Mr Childs, submitted that reg.85's reference to the "the provisions of the Act" could not extend to s.317 of the 1985 Act since that would render the next words (viz. "and provided that he has disclosed to the directors the nature and extent of any material interest of his") otiose.

51. Mr Keen also challenged the RGL board's approval of Xunely's acquisition of La Senza on the basis that all members of the board, including Mr Childs, were conflicted. Mr Keen argued that Mr Childs was to be considered to have had a conflicting interest because he was a close business associate of Mr Paphitis. However, Mr Childs was never at any stage a director of Xunely, and he never had either shares or share options in that company. On the face of it, his interests lay with RGL, of which he was both a director and a substantial shareholder. I doubt

whether the mere fact that Mr **691* Paphitis could be described as a close business associate could mean that Mr Childs had a relevant conflict of interest.

52. Be that as it may, Mr Keen submitted that the director defendants acted in conscious disregard of their duty to further the interests of the Ryman companies and so fraudulently. Such conduct, Mr Keen argued, cannot be authorised or ratified by a board resolution. The minutes of the board meeting of June 15, 1998, represented, Mr Keen suggested, "little more than window dressing, for a clear and deliberate breach of the directors' fiduciary duties to RGL". The arrangements relating to the acquisition of La Senza involved, Mr Keen said, RGL taking all the risks for none of the reward. No one, Mr Keen maintained, could have believed the arrangements to be in RGL's interests.

53. As was pointed out in submissions, one of the matters put forward in the particulars of claim in support of the allegations of fraud and dishonesty is the proposition that "it was obvious and the director defendants were *or should have been* aware that each of them was acting in serious breach of his fiduciary duties" (my emphasis). The complaint that the director defendants "should have been aware" suggests negligence rather than fraud. However, Mr Keen said in submissions that the words "or should have been" were a mistake. The passage ought to have alleged knowledge/wilful blindness.

54. Mr Snowden was prepared to accept that reg.85 of Table A will not have served to release the director defendants from their duties to act in their companies' interests (compare *Movitex v Bulfield (1986) 2 B.C.C. 99403*). However, he stressed, among other things, that it is a director's obligation to do what he *believes* to be in his company's interests (see e.g. *Regentcrest Plc (in liq.) v Cohen [2001] B.C.C. 494* , at [120]). Both he and Mr Kitchener argued that, on the facts, the prospects of Mr Kleanthous establishing that the director defendants had acted otherwise than in what they believed to be the interests of the Ryman companies were poor to non-existent. Among the more compelling of the matters which the director defendants advanced in this context were these:

(i) Absence of motive. Mr Cooke and Mr Towner do not appear to have acquired significant financial interests in La Senza until several years later, and Mr Childs never had any obvious reason to act otherwise than in the interests of the Ryman companies.
(ii) The board minutes. These seem to confirm that the director defendants had the interests of the Ryman companies in mind in June 1998, and showing them to be "little more than window dressing" would not be an easy task.
(iii) The director defendants have put forward a number of reasons for not wanting RGL to acquire La Senza but being prepared to support Xunely's acquisition of it. They echo to

a considerable extent points made in the minutes of the June 15, 1998, board meeting (see [16] above).

55. It was also submitted on behalf of the director defendants that any claim was statute-barred. Mr Keen argued otherwise on the basis that s.21(1)(a) of the Limitation Act 1980 and/or s.32 of that Act applied.

56. Section 21(1) of the 1980 Act provides as follows:

"No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action–

(a) in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy; or

(b) to recover from the trustee trust property or the proceeds of trust property in the possession of the trustee, or previously received by the trustee and converted to his use."

57. This section was considered by the Court of Appeal in *Paragon Finance Plc v D B Thakerar & Co [1999] 1 All E.R. 400* . In that case, Millett L.J. distinguished two different situations in which ***692** the expressions "constructive trust" and "constructive trustee" have been used by equity lawyers (at 408–409):

"The first covers those cases already mentioned, where the defendant, though not expressly appointed as trustee, has assumed the duties of a trustee by a lawful transaction which was independent of and preceded the breach of trust and is not impeached by the plaintiff. The second covers those cases where the trust obligation arises as a direct consequence of the unlawful transaction which is impeached by the plaintiff."

Millett L.J. expanded on the distinction as follows (at 409):

"A constructive trust arises by operation of law whenever the circumstances are such that it would be unconscionable for the owner of property (usually but not necessarily the legal estate) to assert his own beneficial interest in the property and deny the beneficial interest of another. In the first class of case, however, the constructive trustee really is a trustee. He does not receive the trust property in his own right but by a transaction by which both parties intend to create a trust from the outset and which is not impugned by the plaintiff. His possession of the property is coloured from the first by the trust and confidence by

> means of which he obtained it, and his subsequent appropriation of the property to his own use is a breach of that trust … In these cases the plaintiff does not impugn the transaction by which the defendant obtained control of the property. He alleges that the circumstances in which the defendant obtained control make it unconscionable for him thereafter to assert a beneficial interest in the property.
>
> The second class of case is different. It arises when the defendant is implicated in a fraud. Equity has always given relief against fraud by making any person sufficiently implicated in the fraud accountable in equity. In such a case he is traditionally though I think unfortunately described as a constructive trustee and said to be 'liable to account as constructive trustee'. Such a person is not in fact a trustee at all, even though he may be liable to account as if he were. He never assumes the position of a trustee, and if he receives the trust property at all it is adversely to the plaintiff by an unlawful transaction which is impugned by the plaintiff. In such a case the expressions 'constructive trust' and 'constructive trustee' are misleading, for there is no trust and usually no possibility of a proprietary remedy; they are 'nothing more than a formula for equitable relief': *Selangor United Rubber Estates Ltd v Cradock (No 3) [1968] 2 All ER 1073 at 1097, [1968] 1 WLR 1555* at 1582 per Ungoed-Thomas J."

While "the first kind of constructive trust was a creature of equity's exclusive jurisdiction," Millett L.J. said, "the second arose in the exercise of the concurrent jurisdiction" (see 410).

58. Millett L.J. went on to indicate (without deciding) that s.21 of the Limitation Act 1980 does not extend to constructive trusts within the second class. He said, for example, the following (at 409–410):

> "There is no logical basis for distinguishing between an action for damages for fraud at common law and the corresponding claim in equity for 'an account as constructive trustee' founded on the same fraud. Section 21 of the 1980 Act can sensibly be limited to wrongs cognisable by equity in the exercise of its exclusive jurisdiction. It makes no sense to extend it to the exercise of its concurrent jurisdiction."

and: ***693**

> "There is a case for treating fraudulent breach of trust differently from other frauds, but only if what is involved really is a breach of trust. There is no case for distinguishing between an action for damages for fraud at common law and its counterpart in equity based on the same facts merely because equity employs the formula of constructive trust to justify the exercise of the equitable jurisdiction."

59. *In Gwembe Valley Development Co Ltd v Koshy (No.3) [2003] EWCA Civ 1048; [2004] 1 B.C.L.C. 131* , the Court of Appeal concluded that the trust at issue in that case was "a class 2 trust, within Millett LJ's classification" ([119]), with the result that the claim could not be brought within s.21(1)(b) of the Limitation Act 1980 but (in the words of the judgment) "stands or falls on s 21(1)(a) " ([120]). On the face of it, the Court of Appeal was therefore proceeding on the basis that s.21(1)(a) could apply in the case of a class 2 constructive trust. However, in *Halton International Inc (Holdings) v Guernroy Ltd [2006] EWCA Civ 801* Carnwath L.J. observed:

> "I should note that, although the judgment in *Gwembe* (to which I was a party) proceeded on the premise that fraud was sufficient to bring the case within s 21(1)(a) (para 120), the ultimate decision may be better explained by reference to the alternative ground of fraudulent concealment: s 32."

Carnwath L.J. then explained that s.21 :

> "… is about deemed possession: the fiction that the possession of a property by a trustee is treated from the outset as that of the beneficiary. In the words of Millett LJ, the possession of the trustee is 'taken from the first for and on behalf of the beneficiaries' and is 'consequently treated as the possession of the beneficiaries'. An action by the beneficiary to recover that property is not time-barred, because in legal theory it has been in his possession throughout."

60. In *J D Wetherspoon Plc v Van De Berg & Co Ltd [2007] EWHC 1044 (Ch), [2007] P.N.L.R. 28* , Lewison J. commented (at [36]) that the *Gwembe* case was binding on him. Having regard, however, to Millett L.J.'s reasoning in *Paragon* and Carnwath L.J.'s comments in *Halton* , it seems to me that a higher court would be very likely to hold that s.21(1)(a) of the Limitation Act 1980 , like s.21(1)(b) , does not apply to class 2 constructive trusts. That suggests that, for the derivative claim ultimately to succeed on the strength of s.21(1)(a) , Mr Kleanthous would need to establish that there was a class 1 constructive trust.

61. Arguing that this is a class 1 case, Mr Keen said that the reality is that Mr Paphitis took the assets of RGL and improperly used them to purchase La Senza in the name of his own shell company. On the other hand, Mr Kitchener and Mr Snowden each argued that any claim would be within Millett L.J.'s class 2. Mr Snowden, for example, submitted that neither the shares in Xunely nor any remuneration received by any of the director defendants could represent pre-existing property of RGL to which fiduciary obligations attached. As regards the allegation that

funds of the Ryman companies were improperly lent to Xunely, Mr Snowden pointed out that the loans were repaid within a couple of years and said that the Xunely shares in respect of which an account is claimed could not be said to be either an accretion to, or graft upon, the loans.

62. Assuming, however, that (contrary to Mr Kitchener's and Mr Snowden's submissions) this is a class 1 case, Mr Kleanthous would still have to prove in respect of each of the director defendants that there had been fraud (because s.21(1)(a) of the 1980 Act is applicable only to claims in respect of "any fraud or fraudulent breach of trust"). Having regard to matters such as those mentioned in [54] above, establishing fraud would not be easy. ***694**

63. Turning to s.32 of the Limitation Act 1980 , this is in the following terms:

> (1). "… where in the case of any action for which a period of limitation is prescribed by this Act, either–
>
> (a) the action is based upon the fraud of the defendant; or
> (b) any fact relevant to the plaintiff's right of action has been deliberately concealed from him by the defendant; or
> (c) the action is for relief from the consequences of a mistake; the period of limitation shall not begin to run until the plaintiff has discovered the fraud, concealment or mistake (as the case may be) or could with reasonable diligence have discovered it. References in this subsection to the defendant include references to the defendant's agent and to any person through whom the defendant claims and his agent.
>
> (2). For the purposes of subsection (1) above, deliberate commission of a breach of duty in circumstances in which it is unlikely to be discovered for some time amounts to deliberate concealment of the facts involved in that breach of duty."

64. Mr Kleanthous alleges that the letter Mr Paphitis sent him on August 17, 1998 (see [20] above) involved deliberate concealment. The particulars of claim say the following about this:

> "Paphitis' statement in the said letter that '[La Senza] *was not purchased by Chancerealm Ltd and it was not a Chancerealm deal* ' amounted to deliberate concealment by Paphitis (on his own behalf and on behalf of Cooke, Towner and Childs) of the wrongful misuse of RGL (and/or Ryman) funds and the diversion of the La Senza Opportunity and misuse of assets."

65. By the close of argument, Mr Keen was no longer pursuing the suggestion that the correspondence showed there to have been deliberate concealment on the part of Mr Cooke, Mr Towner or Mr Childs; he limited the allegation of concealment to Mr Paphitis. It seems to me, however, that Mr Kleanthous' prospects of showing that the letter involved deliberate concealment even on the part of Mr Paphitis are quite poor.

66. Other factors make it even harder for Mr Kleanthous to rely on s.32 of the 1980 Act. Arguably, the companies whose claims are at issue (viz. RGL and RL) can be said to have known all the relevant facts (through Mr Childs, if not otherwise). Mr Kleanthous himself was evidently aware of the fact that a company associated with Mr Paphitis had purchased La Senza, and it can be plausibly argued that Mr Kleanthous could with reasonable diligence have discovered any other facts relevant to the causes of action. It is relevant in this context that "the statutory words 'any fact relevant to a plaintiff's right of action' are to be given a narrow rather than a wide interpretation" (*AIC Ltd v ITS Testing Services (UK) Ltd (The Kriti Palm) [2006] EWCA Civ 1601; [2007] 2 C.L.C. 223* , at [322]). As was explained in The Kriti Palm (in [322]), in *Johnson v Chief Constable of Surrey, The Times, November 23, 1992* , the Court of Appeal accepted a "submission that 'the relevant fact must be a fact without which the cause of action is incomplete', contrasting a fact relevant to an action and to a *right* of action". It is relevant too that the question is not whether matters *should* have been discovered sooner but whether they *could* have been with reasonable diligence (see the *Paragon* case, at 418). In *Paragon* , the Court of Appeal said (at 418) that "the test was how a person carrying on a business of the relevant kind would act if he had adequate but not unlimited staff and resources and were motivated by a reasonable but not excessive sense of urgency". Mr Kitchener submitted that, in the present case, the published accounts would have been sufficient to put Mr Kleanthous on the scent, especially as he had the assistance of an accountant. ***695**

67. My overall conclusion is that there are arguable claims against the director defendants, but the chances of the claims succeeding are significantly less than evens. The claim against Mr Childs strikes me as particularly weak.

68. With regard to the quantum of the claims, a very large sum could potentially be recovered from Mr Paphitis if an account of profits were ordered. It is much less clear that the Ryman companies would stand to recover very large amounts from Mr Cooke and Mr Towner. On the face of it, Mr Childs has not received any profits for which he could be liable to account.

Factors relevant to whether permission should be given

69. I shall consider in turn below such of the matters listed in s.263 of the Companies Act 2006 as seem to me to be of particular significance in the present case.

Section 263(2)(a) (whether a person acting in accordance with s.172 would not seek to continue the claim)

70. As mentioned above ([38]), s.263(2)(a) is applicable only where *no* director acting in accordance with s.172 of the 2006 Act would seek to continue the claim. I am not satisfied that that is the case as regards Mr Paphitis or even Mr Cooke or Mr Towner. In contrast, I have been persuaded by Mr Snowden and Mr Michael Todd QC, who appears with Miss Mary Stokes for the Ryman companies, that s.263(2)(a) is in point as regards Mr Childs. He is in a somewhat different position to Mr Cooke and Mr Towner since he never had any interest or role in Xunely. As I have already said, the claim against him seems particularly weak, and he does not appear to have received any profits for which he could be liable to account. In the circumstances, I consider that "a person acting in accordance with section 172 … would not seek to continue the claim" so far as Mr Childs is concerned. It follows that I am required by s.262(2) to refuse permission to continue the claim as against Mr Childs.

Section 263(3)(b) (the importance that a person acting in accordance with s.172 would attach to continuing the claim)

71. In *Wishart v Castlecroft Securities Ltd (above)* , Lord Reed said (at [37]):

> "A hypothetical director acting in accordance with s.172, and considering whether to commence legal proceedings, could ordinarily be expected to have regard to a range of factors, including the amount at stake, the apparent strength of the case, the prospects of securing a satisfactory outcome without litigation, the prospects of successful execution of any judgment, the likely cost of the proceedings, the disruption caused to the company's business, and potential risks to reputation and business relationships."

72. I have commented above on the size and strength of the claim, and I am not aware of any reason to think that a judgment would go unsatisfied. As regards costs, these could doubtless be very substantial, but the Ryman companies would probably be in a position to bear them. So far as disruption to business, reputation and relationships is concerned, Mr Kyprianou has advanced a number of reasons for considering that the claim would be very damaging to the Ryman companies. Mr Kyprianou summarised the views of himself and Mr Lakin in these terms in a witness statement: ***696**

"To sum up, Simon [Lakin] and I find it very difficult to contemplate a situation in which the Companies bring a fraud claim (or continue the Derivative Claim) against their major shareholders and the other defendant Directors. However, we believe it would have a devastating effect on the Ryman business for the following reasons:

(a) the Companies are likely to lose four of their most experienced directors. This in turn is likely to damage the trading performance of the RGL Group, staff morale and the reputation of the Companies;
(b) replacing the defendant Directors with candidates of similar skills and experience would be extremely difficult and, in the case of Theo Paphitis, impossible;
(c) damaging the reputation of Theo Paphitis would mean damaging the reputation of Ryman, as Theo Paphitis' name is very closely linked to the Ryman brand. The RGL Group would no longer benefit from the considerable free publicity gained by its association with Theo Paphitis and the numerous business advantages that result from this association;
(d) the impact on employees, customers, suppliers and other shareholders would be disastrous and would be likely to cause a significant deterioration in the RGL Group's performance and consequently its value; and
(e) the litigation would provide a significant distraction to any remaining senior management."

73. Mr Keen understandably sought to minimise the significance of Mr Kyprianou's evidence, but to my mind there is much force in what Mr Kyprianou says.

Section 263(3)(e) (whether the company has decided not to pursue the claim)

74. As explained above ([31]), RGL and RL each set up a committee comprising Mr Kyprianou and Mr Lakin to seek professional advice and make decisions in relation to these proceedings. The committees decided against bringing or continuing the claim.

75. Mr Keen argued that Mr Kyprianou and Mr Lakin are "anything but independent". While, however, Mr Kyprianou has been a director of a number of companies associated with Mr Paphitis, he and Mr Lakin received legal advice on their duties (including that they should not allow the effect of any decision on themselves or other directors to influence them) and had no involvement with Xunely's original acquisition of La Senza. Mr Keen drew my attention to the comment in Boyle, "Minority shareholders' remedies" (Cambridge University Press, 2002), at p.80, that it is "important that allegations of seriously abusive behaviour should not be defeated by assertions of genuine belief by board members or shareholders who think that litigation must always be the worst option; either financially or in terms of corporate reputation". On the facts of the present case, however, I do not think I would be justified in ignoring the conclusions arrived at by the chief executive officer (Mr Kyprianou) and finance director (Mr Lakin) of the relevant companies. To the contrary, I accept Mr Todd's submission that I should attach considerable

weight to those conclusions. Mr Kyprianou and Mr Lakin are better placed than I am to assess where the companies' commercial interests lie.

Section 263(3)(f) (whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than on behalf of the company)

76. The defendants all argue that Mr Kleanthous could pursue his complaints more appropriately by a petition pursuant to s.994 of the 2006 Act (unfair prejudice).

77. Mr Kyprianou said this on the subject in his witness statement: ***697**

> "If the Companies were to bring a claim against the defendant Directors they would be bringing a claim against the majority shareholders, namely Theo Paphitis and Ian Childs, who together own around 85 per cent. of the shares in RGL. Even assuming, for present purposes, that the sums which the Companies could recover are as large as those asserted by Tony Kleanthous, the Companies have no immediate requirement for such very large sums. This means that, after paying legal costs, the majority of any sums recovered by the Companies from the defendant Directors would be likely to be returned to shareholders. Therefore 85 per cent. of any sums recovered, after the payment of costs, would be returned to two of the defendant Directors. We do not consider this a rational way of proceeding when we are advised that Tony Kleanthous could bring proceedings by way of an unfair prejudice petition to obtain a remedy from the defendant Directors for wrongs which he contends he has suffered at their hands without involving the Companies other than as nominal defendants."

78. In *Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Ch); [2008] B.C.C. 885* , Mr William Trower QC, sitting as a deputy High Court judge, gave considerable weight to the fact that the claimant should be able to achieve all that it could properly want through a s.994 petition and shareholders' action which were already on foot (see [53] and [54]). In *Iesini v Westrip Holdings Ltd* , Lewison J. said (in [126]) that the availability of an alternative remedy under s.994 was one of the factors which would have led him to the conclusion that, had he not adjourned the matter, it would not have been appropriate to allow a derivative claim to proceed.

79. In contrast, the availability of an alternative remedy under s.994 did not appear to the Inner House to be a compelling consideration on the facts of *Wishart v Castlecroft Securities Ltd* , where Lord Reed commented (in [46]) that such proceedings would "constitute, at best, an indirect means of achieving what could be achieved directly by derivative proceedings". Similarly, in *Stainer v Lee* Roth J. considered a derivative action "entirely appropriate" and "the theoretical availability to the applicant of proceedings by way of an unfair prejudice petition … not a reason to refuse permission"; the applicant was "not seeking to be bought out" ([52]).

80. In the present case, likewise, it was submitted on Mr Kleanthous' behalf that he was not seeking a buy-out of his shares. However, the evidence indicates that Mr Kleanthous is interested

in being bought out. Mr Kleanthous himself referred in a witness statement to having said to Mr Paphitis in 2008 that he "hoped [Mr Paphitis] would agree to buy [his] RGL shares at a fair price so that [they] could both move on with [their] separate lives". In a more recent witness statement, Mr Kleanthous said that he had "made no secret about the fact that [he] would be willing to sell [his] shares in RGL at a fair price". Further, there has been reference to a petition being presented under s.994 . In a letter dated June 2, 2010, Mr Kleanthous' solicitors said that they had been "instructed to prepare, in addition to the derivative proceedings, an application under Section 994 of the Companies Act 2006 ". One is left with the suspicion that Mr Kleanthous has chosen to pursue derivative proceedings alone in the hope that that he will be able to obtain a costs indemnity (with the result that the other shareholders in RGL would be likely to bear the bulk of the costs even if the claims against them failed).

81. In all the circumstances, I agree with Mr Todd that the availability of an alternative remedy in the form of an unfair prejudice petition is a powerful reason to refuse permission for the derivative claim to proceed in this case.

Section 263(4) (views of members with no personal interest in the matter)

82. Section 263(4) of the 2006 Act directs the court to have "particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, ***698*** in the matter". Mr Snowden referred in this connection to evidence given by Mr Childs. Mr Childs expressed the following, among other, views in a witness statement:

> "… I do not think that it would be in the best commercial interests of RGL (or of me as a minority shareholder) for Mr Kleanthous to be given permission to bring the claims which he seeks to bring on behalf of RGL. RGL bringing proceedings against the majority of its own board will be damaging to the Ryman brand as well as disruptive and very costly … If Mr Kleanthous wishes to pursue his allegations, he has the ability to do so as a minority shareholder in his own right, and can seek a buy-out order for his shares, which is plainly what he really wants."

83. Since Mr Childs is one of the proposed defendants, I doubt whether he is strictly to be regarded as a member with "no personal interest, direct or indirect, in the matter". His views still seem to me to be of relevance, especially since (a) he has a shareholding in RGL which is not very much smaller than Mr Kelanthous', and (b) he does not appear to have benefited in any way from Xunely's acquisition of La Senza.

Conclusion

84. In the end, I did not understand Mr Keen to press me to grant permission for the claim to be continued as against anyone but Mr Paphitis. Mr Keen submitted in his reply that I could most properly grant permission against Mr Paphitis alone on the basis that (a) concealment may not

have been pleaded against the other director defendants and (b) the quantification of any claim is more problematic against director defendants other than Mr Paphitis.

85. I have concluded, however, that I should not grant permission for the claim to be continued at all. I have already expressed the view that s.263(2)(a) applies in relation to Mr Childs (with the consequence that permission has to be refused as against him). With regard to the other director defendants, I do not consider the claim Mr Kleanthous wishes to pursue to be of such strength and size (even in the case of Mr Paphitis) as could make it appropriate for me to grant permission when (a) that course is strongly opposed, on a reasoned basis, by the Ryman companies' independent committees as well as by Mr Childs, (b) it is open to Mr Kleanthous to seek redress by means of an application under s.994 of the 2006 Act, and (c) much of any money recovered from the director defendants could be expected to be returned to them by way of distribution. In fact, factors (a), (b) and (c) would have caused me to hesitate to grant permission even if I had been persuaded that the proposed claim was a strong one.

Other matters

86. Amongst the matters on which I heard argument were (a) whether there is jurisdiction to authorise a "double derivative" action (i.e. one in which a member of a company brings a claim on behalf of a subsidiary of the company), (b) whether the proposed claim would have been allowed to proceed at common law (as required on the facts of this case by para.20(3) of Sch.3 to the Companies Act 2006 (Commencement No.3, Consequential Amendments, Transitional Provisions and Savings) Order 2007 (SI 2007/2194 (C.84)), and (c) whether it would have been appropriate to grant Mr Kleanthous a costs indemnity. Given the conclusions I have already arrived at, I do not think I need explore these questions. ***699**

Outcome

87. In all the circumstances, I shall refuse permission to continue the claim and dismiss Mr Kleanthous' application. I shall further adjourn all consequential matters (including any application for permission to appeal) to a date next term.

(Application dismissed) ***700**

