In The Supreme Court of Bermuda

COMMERCIAL COURT

COMPANIES (WINDING UP)

2022: No. 337

IN THE MATTER OF ISLAND OPHTHALMOLOGY LTD
AND IN THE MATTER OF THE COMPANIES ACT 1981

Before: **The Hon. Chief Justice Hargun**

Representation: **Mr Rhys Williams of Conyers Dill & Pearman Limited for the Petitioner**
Mr John Hindess of Wakefield Quin for the Company
Mr Mark Pettingill of Chancery Legal for Ms Jennifer Faries

Date of Ruling: **22 August 2023**

RULING ON COSTS

HARGUN CJ

Introduction

Costs order to be made upon the making of a winding up order following a contested hearing; whether a director of the company should be made liable to pay the costs of the petitioner and the costs of the company; relevant principles to be applied

1. In the underlying proceedings Dr Jacob Smith ("**the Petitioner**"), by Petition dated 2 November 2022, sought an order that Island Ophthalmology Ltd ("**the Company**") be wound up by the Court under the provisions of the Companies Act 1981("**the Act**") and that Mr Edward Willmott and Mr John Johnston be appointed as the joint provisional liquidators of the Company.

2. The factual ground upon which the Petition was presented was that on 7 October 2022, the Petitioner caused a Statutory Demand to be served on the Company at its registered office pursuant to section 162 (a) of the Act, seeking payment of the outstanding sum of $130,000 said to be owed by the Company to the Petitioner and that the Company had failed to pay all or part of the Statutory Demand within the 21 day period set out therein or at all. The Company opposed the making of the winding up order on three grounds. Firstly, the debt which formed the basis of the Statutory Demand was in fact disputed by the Company bona fides and on substantial grounds. Secondly, that the Company had bona fide cross claims against the Petitioner which exceeded the debt claimed in the Statutory Demand. Thirdly, the Petition should be dismissed on the basis that it was filed for an improper purpose.

3. By its judgment dated 3 March 2023 the Court held that having regard to the totality of the evidence, the Court was satisfied that there was in fact no bona fide dispute on substantial grounds that the Petitioner was a creditor of the Company for at least $130,000. Accordingly, the Court was satisfied that the Petitioner had the requisite legal standing to present the Petition. However, the Court was willing to allow the Company to pursue its

counterclaim in the pending proceedings in the Supreme Court 2022 No 240, and the other cross claims referred to in the written submissions filed on behalf of the Company, by adjourning the Petition to a fixed date on condition that the Company paid into court the sum of $130,000 within 14 days of this judgment. In the end, the Company did not pay that sum into court and the Court made an order winding up the Company pursuant to section 162(a) of the Act. The Court agreed that it will deal with the issue of costs on the papers.

4. The Petitioner contends that since he was the successful party he should have his costs of the Petition on the principle that costs follow the event. The Petitioner further contends that, given the extraordinary facts of this case, those costs should be awarded against the Company's former director, Ms Jennifer Faries. It is said by the Petitioner that Ms Faries procured the Company to treat the Petition as a front in her personal "shareholder dispute" with the Petitioner and to take her side in that dispute. Accordingly, it is said that it is fair and just that she should bear the Petitioner's costs.

5. Furthermore, the Petitioner contends that Ms Faries should also pay the Company's costs of the Petition. In that regard it is said that the Company itself ought never to have resisted the Petition, founded as it was on a debt recorded in the Company's own accounts. In causing the Company to run a groundless defence, the Petitioner argues, Ms Faries was advancing her own interests and disregarding those of the Company and its creditors. Accordingly, it is said that she should bear the costs of that hopeless endeavour. Alternatively, the Petitioner contends that the Court should make a *Bathampton* order that the Companies Court should not be paid out of the assets until all secured creditors have been paid in full.

6. On behalf of the Ms Faries it is submitted that the Court should make the "usual compulsory order" made a winding up petition which provides for the payment of the company's costs for preparing and appearing at the hearing of a successful winding up petition as an expense of the liquidation. It is further submitted that there is no evidence that Ms Faries, in her

capacity as a director of the Company (or in any capacity) acted for an improper purpose or for personal gain in opposing the petition. It is said that there is no factor which would justify making anything other than the "usual compulsory order" being granted.

7. In relation to this application for costs, the Petitioner's counsel filed written submissions dated 20 June 2023 and Ms Faries' counsel filed written submissions dated 23 June 2023. Following the exchange of the written submissions Ms Faries filed her Third Affidavit dated 26 July 2023. The Court allowed Ms Faries to file her Third Affidavit on the basis that the Petitioner's written submissions made serious personal allegations against Ms Faries (of bad faith and impropriety) and in the circumstances it was appropriate that Ms Faries should be given an opportunity to respond to those allegations in terms of her Third Affidavit. However, the Court allowed the Petitioner an opportunity to respond, if he so wished, by or before the close of business on 15 August 2023. The Petitioner responded in the form of Supplementary Submissions dated 15 August 2023. The Court has considered all the submissions made in the written submissions of the parties together with the affidavit evidence including the Third Affidavit of Ms Faries.

8. In the matter of *Titan Petrochemicals Group Limited (Costs)* [2021] SC (Bda) 89 Com, this Court adopted the guidance offered by Coulson LJ in *Goknur Maddeleri Enerji ve Sanayi As v Aytacli* [2021] 4 WLR 101 (internal citations omitted):

> ***"40*** *Without in any way suggesting that these authorities give rise to a sort of mandatory checklist applicable to a company director or shareholder against whom a section 51 order is sought, I consider that the relevant guidance can usefully be summarised in this way:*
>
> *(a) An order against a non-party is exceptional and it will only be made if it is just to do so in all the circumstances of the case.*
>
> *(b) The touchstone is whether, despite not being a party to the litigation, the director can fairly be described as "the real party to the litigation".*

(c) In the case of an insolvent company involved in litigation which has resulted in a costs liability that the company cannot pay, a director of that company may be made the subject of such an order. Although such instances will necessarily be rare, section 51 orders may be made to avoid the injustice of an individual director hiding behind a corporate identity, so as to engage in risk-free litigation for his own purposes. Such an order does not impinge on the principle of limited liability.

(d) In order to assess whether the director was the real party to the litigation, the court may look to see if the director controlled or funded the company's pursuit or defence of the litigation. But what will probably matter most in such a situation is whether it can be said that the individual director was seeking to benefit personally from the litigation. If the proceedings were pursued for the benefit of the company, then usually the company is the real party. But if the company's stance was dictated by the real or perceived benefit to the individual director (whether financial, reputational or otherwise), then it might be said that the director, not the company, was the "real party", and could justly be made the subject of a section 51 order.

(e) In this way, matters such as the control and/or funding of the litigation, and particularly the alleged personal benefit to the director of so doing, are helpful indicia as to whether or not a section 51 order would be just. But they remain merely elements of the guidance given by the authorities, not a checklist that needs to be completed in every case.

(f) If the litigation was pursued or maintained for the benefit of the company, then common sense dictates that a party seeking a non-party costs order against the director will need to show some other reason why it is just to make such an order. That will commonly be some form of impropriety or bad faith on the part of the director in connection with the litigation.

(g) Such impropriety or bad faith will need to be of a serious nature and, I would suggest, would ordinarily have to be causatively linked to the applicant unnecessarily incurring costs in the litigation."

9. In *North West Holdings Plc (In Liquidation)* [2001] EWCA Civ 67 Aldous LJ also considered the circumstances in which a director could be made liable for costs of legal proceedings against the company and at [343] held:

"33. It was made clear in *Aiden Shipping* *that it was for the appeal courts to lay down the principles that need to be taken into account when exercising the jurisdiction given by section 51 of the 1981 Act. Thus, since* *Taylor v Pace Developments,* *it has been clear that* ***it is not the normal rule that directors should be made to pay the costs of the company, even if they know that the company will not be able to pay any costs if the defence fails.***

34. A crucial question is whether the relevant directors (or director) hold a bona fide belief that (i) the company has an arguable defence, and (ii) it is in the interests of the company for it to advance that defence. If they do then, (in the absence of special circumstances) to make them pay costs of proceedings in which they are not a party would constitute an unlawful inroad into the principle of limited liability. ***It follows that directors of a company which is served with a petition would be well advised to consider with the company's, or their, legal advisers what defences the company has and, having regard thereto, whether it is in the interests of the company to defend the petition. If the bona fide decision of the directors (or director) is that it is, (in the absence of special circumstances) the directors (or director) should be able to cause the company to defend without fear of being made liable to pay any costs****, unless the position should change materially during the lead up to the hearing, or at the hearing. If so, the decision would need to be reconsidered."* (emphasis added)

10. In applying this guidance to this case, the Court considers the following aspects of the case to be relevant.

11. First, whilst the Court has ruled, upon the correct interpretation and analysis of the Company's documents, that there was no *bone fide* dispute on substantial grounds that the Petitioner was a creditor of the Company for at least $130,000, the Court does not consider that it was wholly unreasonable for the Company to raise the issue whether the funding provided by the Petitioner was repayable by the Company as a loan and/or whether it was repayable on demand.

12. The Shareholders Agreement provided under the heading "**Capital**" that "*Jenny and Jake will each contribute $300,000 to the start-up costs of the business*." The Shareholders Agreement was drafted by Mr Trevor Boyce, an accountant, who states that he never intended the Shareholders Agreement to serve as a legal document and that the document was intended merely to form the basis of a more detailed agreement to be drafted by lawyer. He says that there was discussion around the amount of the funding required for the venture but no discussion regarding the structure of that funding. He "***assumed** that any funding would be by way of a loan as all early forecasts suggested that **the business would be very profitable and therefore the start-up <u>monies would be available to return to the shareholders quite quickly</u>***." At [20] of his affidavit Mr Boyce states: "*It was clear that the funds needed would only be to start-up the business, and then the profit would sustain it. I believe that it was **the shared understanding and intention of Dr Smith and Ms Faries that the start-up funding either of them contributed would be repaid to them <u>once the business could sustain itself</u>***."

13. Upon receipt of the payment of $140,000 from the Petitioner in August 2021, the Company accounts recorded that sum as a "***Long Term Liability***" due to the Petitioner in contrast with other liabilities of the Company which were described as "***Current Liabilties***", suggesting that the Company did not consider that the receipt of $140,000 from the Petitioner as a "*current liability*" of the Company.

14. Second, it is a matter of importance that Ms Faries, in her capacity as a director of the Company, took legal advice as to whether the Company's position in relation to funding provided by the Petitioner was legally sustainable. In her Third Affidavit Ms Faries states that: "***I was advised by the lawyers that there was a valid dispute over the loan in relation to the dispute over the contributions [the Petitioner] failed to make**. As I stated in my affidavit, I did not think of the contributions as a loan **that was repayable on demand**- I believed the company was protected by the shareholders' agreement which showed that [the Petitioner] and I had both agreed to contribute $300,000, and he had still not done so that day. He had not fulfilled his initial agreement, nor the agreement which was meant to*

replace that (the agreement to lease the equipment), so it was my understanding that he still owed the company the balance of $300K he had agreed to contribute, or to lease the equipment as promised. Thus, this loan could not simply be demanded back… ***I had relied heavily on the company lawyers and accountants to help me understand the legalities of the loan and contributions, and the court decided that we/they were wrong****."*[1]

15. Ms Faries' evidence in relation to the receipt of legal advice from the Company's attorneys, as set out in her Third Affidavit, is consistent with the position taken by the Company's attorneys in the pre - litigation correspondence. Thus, in a letter dated 24 October 2022 the Company's attorneys wrote to the Petitioner's stating that:

> *"A Winding Up Petition is not a legitimate means of seeking payment for a debt when it is in dispute as is clearly the case in the circumstances (noting that you have acknowledged the funds are in dispute in your letters). Therefore, if you file a Petition we will apply to have been struck out and seek to rely on our previous correspondence and this letter and seek costs on an indemnity basis. We would therefore strongly encourage your client to withdraw the Statutory Demand and filed a writ if he believes the funds are owed to him now."*[2]

16. Third, this does not appear to be a case where the litigation pursued on behalf of the Company was directly funded by Ms Faries. It appears that Wakefield Quin were directed directly on behalf of the Company and in due course they rendered their invoices to the Company itself.

17. Fourth, the Court does not consider that the Company's opposition to the winding up Petition presented by the Petitioner was primarily motivated by Ms Faries' pursuit of her personal interest. The Court accepts Ms Faries' evidence that her primary goal at all times

[1] The legal advice received by the Company in relation to the winding up proceedings should be in the possession of the Joint Provisional Liquidators, who have been advised of the existence of this application (see the email from Mr Rhys Williams to the Registrar dated 9 August 2023 and copied to Ms Zuill, counsel acting for the JPLs of the Company).

[2] It is noted that the Petitioner's attorneys denied at the hearing that they ever acknowledged in their letters that the funds owed to the Petitioner were in dispute.

was to keep the Company going so as not to disrupt patient care. The Court also accepts Ms Faries' evidence that she started Insight Ltd so that, in the event that the Company was forced to wind up, she could provide that care soon afterward with as little disruption as possible.

18. Fifth, the Court does not accept the submission made on behalf of the Petitioner that costs order against Ms Faries is warranted because Ms Faries acted demonstrably in bad faith and with impropriety in conducting the Company's defence. As set out above, although the Court has found against the Company, Ms Faries's belief that the funding advanced by the Petitioner was not repayable on demand was not wholly unreasonable; the position taken by the Company in the winding up proceedings was taken with the benefit of legal advice; the position taken by the Company was not taken primarily with a view to advancing Ms Faries' personal interest; and that the defence of the Company's position was not pursued by Ms Faries in bad faith.

19. The Court has considered the submissions set out in the Petitioner's written submissions dated 20 June 2023 and 15 August 2023 of Ms Faries dated 23 June 2023 including the petitioner submissions based upon the partial repayment of the loan to Ms Faries herself and her response as set out in paragraphs 2 and 3 of her Third Affidavit. Having considered the totality of the submissions made by the parties and in the exercise of its discretion, the Court is satisfied that it would be wholly unjust and disproportionate to require Ms Faries to pay the Petitioner's and the Company's costs of these proceedings. In all the circumstances the Court is satisfied that the appropriate order to make is the usual order upon the making of a winding up order. Accordingly, the Court orders that (i) the Petitioner's costs; and (ii) the Company's costs for preparing and appearing at the hearing of these proceedings , shall be paid by the Company as an expense of the liquidation.

20. Unless either party applies to the Court within the next 21 days seeking different relief, the Court makes no order as to costs in relation to this application.

Dated this 22nd day of August 2023

NARINDER K HARGUN
CHIEF JUSTICE