

Briefing Note July 2017

Fraud Prevention: The Royal Court's New Power

This note is for information purposes only and is not intended to be legal advice.

The *Companies (Guernsey) Law 2008* defines a "member" of a company as one whose name appears in the company's register of members. But what if the name of a member was entered (or removed) as a result of fraud or unlawful conduct and a party relied upon such to control the company for their own benefit? That issue was recently examined by the Royal Court, which had to employ a new weapon to combat this fraudulent conduct.

At the conclusion of a trial in the long running *Protec International* proceedings, the Royal Court found that a director had wrongfully removed another director, manufactured an unlawful forfeit of shares and relied upon a forged share transfer in order to gain control of the board of the company and the majority of its shares. Subsequent to this misconduct, two disaffected members of the company sought to hold an extraordinary general meeting in an attempt to remove the rogue director and unwind his wrongful actions.

According to the company's articles, the meeting would only be quorate if at least two members holding at least five per cent of shares were present.

Importantly, due to the misconduct described above, the name of one of these members did not appear in the members' register at the time of the meeting. Therefore, the Royal Court had to determine if the business of the meeting (including the removal of the rogue director) could be valid.

In determining this issue, the Royal Court, for the first time, accepted that it has a customary law power to retrospectively rectify a company's register of members.

Adopting an English line of authorities cumulating in the English Court of Appeal decision in *Smith v Charles Building Services Limited* [2006] EWCA CIV 14, the Court held that the power was discretionary and not exercisable as a right. However, whilst recognising the power, the Court also accepted its limitations; namely, that the discretion will only be exercised so as to do justice to the applicant party and will not unfairly prejudice the rights of any innocent third parties.

On behalf of the rogue director it was argued that third party rights had intervened, since third parties

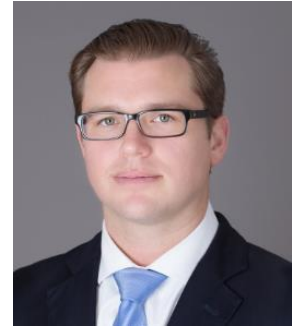
had received assets of the company following a UK administration. The Court rejected this on the basis that no actual prejudice could be shown and the third parties identified were all associates or otherwise connected to the rogue director. The Court held that the rogue director should not be able to achieve by the back door a result which is contrary to the just interests of the excluded member and thereby benefit from his own wrongdoing.

The *Protec International* case highlights the need for share registers to be untainted by fraud. In the event they are, the Court now has a power to act. The recognition of the power of retrospective rectification represents yet another tool in the arsenal of the Courts to combat fraudulent conduct with respect to the affairs of Guernsey companies.

Dispute Resolution Partner, Advocate Todd McGuffin, assisted by Associate, Bryan Little, successfully argued for the recognition of this new power.



Todd McGuffin
Tel: +44 1481 746145
t.mcguffin@babbelegal.com



Bryan Little
Tel: +44 1481 746186
b.little@babbelegal.com