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Gamlestaden Fastigheter AB v Baltic Partners & Others [2007] 4 All ER 164 PC

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The decision of the Privy Council in the Gamlestaden case marks the end of attempts to strike out a very substantial claim against professional directors, emphasises the breadth of the unfair prejudice jurisdiction and clarifies the law in three important respects. First, the case makes clear that the insolvency of the company is not necessarily a bar to the grant of relief. Secondly, once a member has brought himself within the scope of the jurisdiction by establishing that the affairs of the company have been carried on in an unfairly prejudicial manner, it is not necessary for the relief granted to enhance the value of his shares. Thirdly, the scope of the unfair prejudice jurisdiction is wide enough to allow for an holistic approach to the nature of a member's investment in a joint venture company which may often be made partly in the form of equity and partly in the form of loans.

In 1989 Tryggwe Karlsten wanted a partner to provide funding for investment in German commercial property and in two projects in particular, both located in Hamburg's Kontorhaus district, claimed to be the first dedicated office district on the continent of Europe, namely Chilehaus, and Sprinkenhof, two massive pre-war Fritz Höger buildings. There is plenty of material, including photographs, of these important buildings available on the internet for any reader sufficiently interested in German expressionist architecture.

Karlsten persuaded a consortium of Swedish banks to form a joint venture company with him and his associate Mr Hansen and to fund the development. The parties chose Jersey as the jurisdiction in which to incorporate the joint venture company and Coopers & Lybrand, as they then were, to provide professional directors to run it. Baltic Partners Limited was duly incorporated; its only asset was an interest in a German limited partnership, Scandinavian Partners Karlsten & Co KG (SPK). Baltic contributed all the capital to the partnership, save for a token amount contributed by Karlsten's associate Mr Hansen. Karlsten contributed no funds at all.

The articles governing SPK provided that each partner was to have three accounts: first, an equity account 1, to which the capital contributions of Baltic and Mr Hansen were credited and which had to be repaid before profits could be distributed, second, an equity account 2, to which the respective profit shares of the three partners would be credited (Karlsten 73%, Baltic 22% and Hansen 5%) and a loss carried forward account to which any losses were to be charged. Profits were to be applied in discharging losses before credits could be made.

SPK acquired Sprinkenhof and a 95% interest in Chilehaus. The acquisition necessitated heavy borrowing, much of which came from Gamlestaden's parent company and substantial sums from two Swedish banks, Skandinaviska Enskilda Banken and Sparbanken Sverige, repayment of which was guaranteed by Gamlestaden's parent.

In January 1993 SPK obtained a valuation of Sprinkenhof based on assumptions that it would be refurbished. In or about May 1993, unknown to Gamlestaden, Karlsten and Hansen withdrew over DM 112 million from SPK on the signed authority of the three partners. The directors of Baltic signed the authority for the withdrawal. Although Chilehaus was sold successfully in June 1993, the effect of these large withdrawals was to leave SPK without cash to refurbish Sprinkenhof. A few months later, again without the knowledge of Gamlestaden, the three SPK partners agreed to convert SPK into a limited liability company, Scandinavian Partners Grundstücksgesellschaft mbH; in the course of the conversion the debit balances represented by the withdrawals were eliminated from the accounts of SPK/SPG. Once again, this was done with the consent of the Baltic directors. Ignorant of these transactions, Gamlestaden had difficulty understanding why the refurbishment of Sprinkenhof was not proceeding as planned. Eventually Sparbanken, as creditor, sought to have Baltic placed *en désastre* so that the Viscount might investigate what had happened within Baltic and SPK; thus the events described above came to light. The *désastre* was appealed by the directors in Baltic's name, contesting the Sparbanken debt, and was subsequently set aside by the Court of Appeal so the Viscount's investigations came to nothing. The validity of the debt was successfully established in proceedings in the Swedish courts, which concluded in March 2002. Baltic appealed that decision but in 2003 the directors withdrew the appeal.

Gamlestaden commenced a derivative action in the courts of Jersey, but that claim was struck out on the directors' application, on the ground that it could not be brought within any of the recognised exceptions to the rule in *Foss v Harbottle* (1843) 2 Hare 461. Gamlestaden appealed that decision and the appeal was adjourned so that it could consider making an application under Arts 141-143 of the Companies (Jersey) Law 1991 (which are in substance identical to Sections 459-461 CA 1985 and Sections 994-996 CA 2006). The relief sought included an order for payment by the directors to Baltic of damages for breach of duty and alternatively an order authorising Gamlestaden to continue the derivative proceedings. Those proceedings were likewise struck out by the Bailiff in the Royal Court of Jersey, and his decision was upheld by the Jersey Court of Appeal. One of the principal grounds of the decision to strike out was that it was not open to a member of a company to make an unfair prejudice application for relief in circumstances where the company was insolvent (as Baltic was said to be) and would remain insolvent whatever order was made so that the members would obtain no financial benefit in their capacity as members.

The first question dealt with by the Board was whether relief could be granted under Art 143 requiring the payment of damages to a company whose affairs have been conducted in an unfairly prejudicial manner and, following a decision of the Hong Kong Court of Final Appeal in *Re Chime Corp Limited* [2004] 3 HKLRD 922 the Board held that it could.

The next, and central question, was whether insolvency was a bar to the exercise of the jurisdiction. The Board noted the breadth of the Art 143 discretion conferred on the court. It noted that in reality a large part of Gamlestaden's investment in Baltic took the form of the provision of loans to Baltic so that Baltic could fund SPK. Baltic was the corporate vehicle through which the joint venture enterprise of investment in German commercial property was to be pursued. If mismanagement by the directors of that corporate vehicle had led to loss, the Board regarded it as 'artificial' to insist that the qualifying loss for the purposes of the statute had to be loss which had reduced the value of the investor's equity capital and that it would not be sufficient to show that it had reduced the recoverability of the investor's loan capital. It approved *R & H Electric Ltd v Haden Bill Electrical Limited* [1995] 2 BCLC 280 where Robert Walker J (as he then was) referred to arrangements made at the time the company was formed under which loans were made by one of the investors as 'a reflection of, and sufficiently closely connected with ... membership of [the company] as to be within the scope of s459'. In the opinion of the Board, it would be inconsistent with the purpose of the statutory provisions to limit the availability of the remedies they offer to cases where the value of the shares held by the applicant member would be enhanced by the grant of relief sought. If the relief sought would be of real, as opposed to merely nominal, value to an applicant joint venturer in facilitating recovery of some part of its investment in the joint venture company that would suffice to provide locus standi for the application to be made. The Board reiterated the wide scope of the equivalent English sections. They accepted Gamlestaden's submissions that those sections did not rule out the grant of relief simply because the relief sought would not benefit the applicant in his capacity as a member, but there had to be some real financial benefit to be derived from the relief granted, whether as a shareholder or in some other way. The Board concluded that the Bailiff and the Jersey Court of Appeal had construed the section too narrowly and the appeal against the striking out was allowed with costs.

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