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BREXIT AND THE LEGAL IMPLICATIONS FOR CROSS-BORDER INSOLVENCIES: WHAT DOES THE FUTURE HOLD FOR THE UK?

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Despite the continued development of national insolvency rules and regulations, English insolvency and restructuring procedures are still very well regarded across the world. The desirability for English law rests with its ability to provide a highly flexible, comprehensive restructuring toolkit that can adapt according to circumstances, and when warranted, it can rely on the commercial knowledge of the judiciary for input. It remains common practice for creditors who provide funds to a foreign company to dictate the law that they wish to apply. This can be achieved through a variety of methods such as simply selecting the type of law to govern a contract, by including trigger clauses within the contracts that provide in the event of a dispute the matter should be referred to a particular jurisdiction, or by the creditor shifting the centre of main interests (COMI) to the UK. Such is the respect for the UK’s cross-border insolvency and restructuring regime, aspects of the English insolvency procedures across Europe are afforded wide recognition. Receiving such recognition has meant that the influence of English insolvency procedure is extensive, that has in turn provided a stable and predictable system for commercial parties to rely upon when structuring cross-border deals and making investment decisions. To this end, Brexit, in whatever form, could have a major impact on such recognition. It will be some time before the actual impact can be fully determined, but the mere threat that it could deter creditors from using English insolvency and restructuring procedures

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ABOUT THIS NEWSLETTER

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should encourage the UK to consider its options.

CROSS-BORDER INSOLVENCY LAW: THE CURRENT POSITION

There are a number of strands that are applicable to cross-border insolvency law. It should be noted that given the proposed timeframe for Brexit, by the time it is realised there will be a number of changes to the legal landscape. These strands are:

- Within Europe, the key EU legislation is the EU Regulation on Insolvency Proceedings 2015/848 (EURIP). The recast EURIP comes into force on 26 June 2017, modernising the scope of the predecessor ECRIP 1346/2000 by, amongst other things, bringing pre-insolvency "rescue" procedures within its remit. Other European legal instruments of relevance are the Financial Collateral Directive 2002/47, the Insurers Winding Up Directive 2001/17 and the Credit Institutions Winding Up Directive 2001/24.
- The Cross Border Insolvency Regulations 2006 (SI 2006/1030) (CBIR) implemented the UNCITRAL Model Law on Cross-Border Insolvency, providing a framework for recognition made by a foreign representative of a debtor with its centre of main interests or an establishment in the foreign jurisdiction.
- Section 426 of the Insolvency Act 1986 enables any court in the UK to assist those courts with corresponding insolvency jurisdiction in any other part of the UK or any relevant country or territory, and to apply comparable insolvency law applicable by either court. Such relevant territories include the Channel Islands, the Isle of Man, the Republic of Ireland and a number of Commonwealth and former Commonwealth members whose laws are based on common law systems, some of which have similar provisions to assist courts in the UK. Requests for assistance must come from foreign courts rather than directly from foreign office-holders.
- The Foreign Judgments (Reciprocal Enforcement) Act 1933 applies to the judgments of the courts of certain listed countries (which includes for example Australia, Guernsey, India and parts of Canada), but as it is bilateral in nature it is limited in scope.
- Common law: the English courts may also assist overseas office-holders under common law principles but this does not assist in any way with reciprocal recognition of English proceedings. Although not an insolvency proceeding falling with the ambit of the EURIP, the English courts have accepted jurisdiction in approving schemes of arrangement under Pt 26 of the Companies Act 2006 in relation to overseas debtors where there is a sufficient connection with English law in circumstances where a scheme would be recognised by another EU Member State in which the debtor has its centre of main interests. English law schemes are useful in effecting restructurings of EU incorporated companies.

THE CHANGING LANDSCAPE: ISSUES RELEVANT TO CROSS-BORDER INSOLVENCIES

As it stands, it is difficult to determine the extent of change that will occur to the post-Brexit landscape. That said, there are themes that are developing within this field; two of which are integral to the future development of cross-border insolvency law and must therefore be considered.

INSOLVENCY PROCEEDINGS: (RECAST) EURIP

The recast EURIP is in force from 26 June 2017. The recast EURIP aims to update the ECRIP, which in turn revolutionised the landscape for commercial parties involved in cross-border insolvency cases in the EU when it was introduced in 2002. The recast EURIP accepts that changes are needed to ensure that the ECRIP (and the recast EURIP) remain applicable, in relevance and scope, to the issues that can materialise within cross-border insolvency regimes. The crux of the matter with Brexit is that recognition under EURIP is reciprocal and automatic in nature so the UK with its current position as a Member State within the EU has the benefit that allows insolvency practitioners quickly and easily to take control of, and realise, an insolvent company's assets that are situated in another EU country. Brexit would likely lead to the UK to revert back to the pre-ECRIP system (but may be able to rely on some case law developed which have since become part of the common law area) and this could dramatically change the existing cross-border process since court applications would be required in each jurisdiction where assets belonging to the insolvent party were situated, asking the court to recognise their authority to act and to represent the insolvent company, and then to apply for permission to repatriate their assets. Such a process would be costly and time consuming and to this end the outcome of Brexit would act as a deterrent to securing investment in UK companies. It would also likely deter companies from having their European COMI in the UK—all of which would have a detrimental impact on the UK economy.

That said, Brexit will not just mean change for the UK since cross-border insolvencies are a two-way process with insolvency practitioners in other Member States which have assets in the UK would need to apply to the UK for recognition. Foreign insolvency proceedings seeking recognition in the UK would be forced to rely on the Insolvency Act s.426, the common law and CBIR which are in comparison to the EURIP much more limited in scope. It is therefore in the interest of all Member States to address this problem as a matter of priority. To what extent will these discussions be forthcoming will be challenging as the relationship between the UK and the EU may be frayed at that point.

HARMONISATION OF EUROPEAN INSOLVENCY LAWS

The European Commission (the "Commission") in its 2014 report *On a New Approach to Business Failure and Insolvency* (available at *http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf* [Accessed on 21 June 2017]; see (2014) 351 Co. L.N. 5) proposed recommendations to harmonise European insolvency laws. The objective was put on the Commission's agenda for 2016 which, among other things, aimed to restructure frameworks across EU Member States. In addition, it recommended that protection should be provided to the providers of new financing. This latter recommendation is part of wider efforts that was put forward in the Commission's *Capital Markets Union Action Plan* 2015 (available at *http://eur-lex.europa.eu/legal-*

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content/EN/TXT/?uri=CELEX%3A52015DC0468 [Accessed 21 June 2017]; see (2015) 377 Co. L.N. 4). This recommendation proposes a Directive to develop three key elements, namely: common principles on the use of early restructuring frameworks; rules to allow entrepreneurs to benefit from a second chance; and produce targeted measures for member states to increase the efficiency of insolvency, restructuring and discharge procedures. Since it was published the Commission notes that the recommendations have only been implemented partially across EU Member States. Many divergent national insolvency laws have given rise to uncertainty as to who owns secured assets and whose rights take precedence in the event of a default, hampering the timely restructuring of viable companies in financial distress, and with it form a barrier to the free flow of capital. It is fortunate that despite the issues in other Member States the UK has advanced restructuring laws as any required amendments should be done with ease.

ADDRESSING SOME OF THE CHALLENGES POST-BREXIT

Following on from the themes identified above, the challenges faced with the Commission's progressive agenda comes into sharp focus when it is clear that since the UK is leaving the EU, it would lose its seat at the table to influence developments concerning the recast EURIP and the harmonisation project. Likewise, UNCITRAL is proposing change to extend the Model Law on Cross Border Insolvency (implemented in the UK by the CBIR) to allow, amongst other things, recognition and enforcement of foreign insolvency related judgments. This is of particular importance since so few EU Member States have implemented the Model Law (currently only Greece, Poland, Romania, Slovenia and the UK (including Gibraltar)) and therefore it currently does not provide a comprehensive alternative to the EURIP.

Specifically, some of the issues that the UK needs to consider are as follows:

RECOGNITION, AND THE ENFORCEMENT OF ORDERS AND JUDGMENTS

Following Brexit, recognition and the enforcement of orders and judgments made and given in foreign insolvency proceedings will no longer be automatic where those proceedings are being conducted in an EU Member State. Instead, the UK may have to rely on other avenues to secure recognition, finding assistance in the following provisions:

- the common law doctrine of modified universalism which allows for recognition and assistance, but not the enforcement of orders and judgments: *Rubin v Eurofinance SA* [2012] UKSC 46; [2013] 1 A.C. 236; [2013] B.C.C. 1; *Singularis Holdings Ltd v PrincewaterhouseCoopers* [2014] UKPC 36; [2015] A.C. 1675; [2015] B.C.C. 66;
- s.426 of the Insolvency Act 1986, which gives a statutory power to assist upon request for assistance by courts of designated jurisdictions—covering most of the Commonwealth and the Republic State of Ireland;
- the Cross-Border Insolvency Regulations 2006, which enact into UK law the Model Law adopted by UNCITRAL in 1997. The Regulations provide for recognition and the giving of assistance, but not the enforcement or orders and judgments; and
- common law principles can, in the absence of any other treaty or convention, govern the enforcement of the orders of foreign courts.

SCHEMES OF ARRANGEMENT–WILL THEY CONTINUE?

It is expected that Brexit will have limited impact on the popularity of the English scheme of arrangement since the scheme falls outside of the recast EURIP. As a "rescue" mechanism it operates as a European restructuring tool and the jurisdictional barriers are easily overcome since the approval of a scheme are satisfied if there is a "sufficient connection" with England and Wales, and English law-governed agreements suffice for this purpose. The difficulty arises with whether the scheme falls within the Judgments Regulation 1215/2012 and therefore benefit from EU-wide recognition under that Regulation.

BRUSSELS REGULATION (THE JUDGMENTS REGULATION): AUTOMATIC RECOGNITION OF COURT JUDGMENTS

Following on from the scheme of arrangement it is debateable as to whether these are within the Judgments Regulation 1215/2012 and therefore benefit from EU-wide recognition under that Regulation. The EU and the UK have provided differing viewpoints on the matter, but what appears to be clear is that the position post-Brexit will mean that the Regulation will not apply to schemes. Invariably, such an outcome will lead to some confusion and questions will be raised concerning foreign companies and the jurisdiction that applies and the recognition given to UK court-sanctioned schemes. To address the Judgments Regulation becoming redundant and the schemes losing its recognition, much reference has been made to the Lugano Convention (on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters). The UK is currently a party to the Lugano Convention through its membership of the EU which provides a similar regime to that applicable under the Judgments Regulation for the recognition and enforcement of judgments (except it applies to EU Member States and European Free Trade Area states other than Liechtenstein). Post-Brexit it would be possible for the UK to rejoin the Lugano Convention and mitigate the challenges that would face the schemes. Thereby a post-Brexit membership could be highly desirable.

COMPETITION FROM OTHER EU MEMBER STATES

Brexit could lead to uncertainty regarding the recognition of foreign insolvency proceedings since it would not be automatic where those proceedings are being conducted in an EU Member State. With a lack of recognition, it is likely that the UK will face some stiff competition from other EU Member States, such as the Netherlands, who are in the process of presenting its revised restructuring regime that mimics the scheme of arrangement as a viable alternative for businesses who wish to continue to have a presence within the EU.

It is likely that differences between Member States will be kept to a minimum to avoid uncoordinated and inconsistent approaches

adopted by different courts in different jurisdictions in a cross-border matter. The nature of the Model Law is to address such issues, but what remains critical is the manner it is applied and the domestic courts play a vital role in the process. To this end it is already evident that steps have been taken on this front with the British Virgin Islands courts recently joining the judiciaries from New York, Delaware, Singapore, Bermuda and the UK, in adopting guidelines for communications and cooperation amongst courts from different jurisdictions on cross-border insolvency matters.

THE JURISDICTION OF THE COURT OF JUSTICE OF THE EU (CJEU)

Should an agreement occur between the UK and the EU, the next obstacle to overcome would be to determine how an EURIP-like measure would operate without the possibility of recourse to the CJEU. While the discontinuance of this position may be inconceivable it would appear paradoxical to the purpose of Brexit, should the CJEU continue to have jurisdiction to resolve disputes following the changes post-Brexit. Further reforms and judge-made decisions that affect the EURIP would also pose problems to the UK. It may be desirable, if possible, to devise a specific opt-in clause for the UK to remain part of the EURIP, and should any cross-border issues arise the UK agrees to allow the CJEU to resolve the dispute. How well this position would work in practice, or even if this proposal is tenable, remains to be seen.

RECOMMENDATIONS

In terms of the UK's position post-Brexit, it is paramount to ensure that the UK remains an attractive place to do business as well as taking measures to strengthen its reputation as a key player within European insolvency. To achieve this, it is proposed that any future reform should consider the following:

- It is paramount to ensure that the benefits of the EURIP are preserved in negotiations via an equivalent treaty between the UK and the EU. The automatic recognition which applies to the UK's insolvency procedures makes the UK an attractive place to do business. Therefore, measures must be taken to ensure that the recognition is protected.
- The UK Government could consider entering into a similar agreement to the Brussels Recast Judgments Regulation.
- The UK could join the "Lugano Convention 2007", which imposes a similar regime to the Judgments Regulations in relation to enforcement of judgments between EU Members States, Switzerland, Iceland, and Norway.
- The UK could look to expand s.426 of the Insolvency Act 1986 to include further designated countries (perhaps all EU Member States) to widen its scope.
- The UK could take the opportunity radically to rethink its cross-border insolvency approach and create a new restructuring law akin to the US Bankruptcy Code Ch.11.

CONCLUSION

Brexit will continue to attract much debate as to what will be the challenges faced post-Brexit, what the UK's response should be and whether Brexit should be seen as an opportunity for the UK to redesign its cross-border insolvency rules. The next few years are likely to provide much more of an outline as to what legal and political climate Brexit will occur in. Until then the crystal-ball gazing will continue.

NEWS DESK

A paragraph number in or following an item refers to a commentary paragraph in Palmer's Company Law (P.C.L.) or in British Company Law and Practice (B.C.L.P.).

CORPORATE INSOLVENCIES INCREASED IN FIRST QUARTER COMPARED TO UNDERLYING NUMBER IN PREVIOUS QUARTER

Statistics issued by the Insolvency Service on 28 April show that the number of corporate insolvencies decreased by 29.1 per cent in the first quarter of 2017 compared to the unusually high number in the previous quarter, when 1,796 connected personal service companies (PSCs) entered liquidation (see (2017) 392 Co. L.N. 6) following changes to claimable expense rules.

Excluding these PSCs, the number of companies entering insolvency in the first quarter of 2017 rose by 4.5 per cent compared to the underlying number in the fourth quarter of 2016 and by 5.3 per cent compared with the same quarter in 2016. An estimated 3,967 companies entered insolvency proceedings in the first three months of the year, consisting of 2,693 creditors' voluntary liquidations (CVLs, 68 per cent of all insolvencies), 836 compulsory liquidations (21 per cent) and 438 other insolvencies (11 per cent).

The number of companies entering creditors' voluntary liquidation in the first quarter of 2017 rose by 5.3 per cent compared with underlying figures for the fourth quarter of 2016, and by 5.4 per cent compared to the corresponding first quarter of 2016. Excluding the fourth quarter of 2016, CVLs were at their highest level since the first quarter of 2014. The number of companies subject to compulsory liquidation in the first quarter of 2017

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increased by 3.3 per cent compared with the previous quarter, and by 2.8 per cent compared to the first quarter of 2016.

Administrations rose slightly—by 2.1 per cent compared to the fourth quarter of 2016 and by 13 per cent compared to the first quarter of that year—but remained on a fairly stable trend. There were 81 company voluntary arrangements in the first quarter of 2017, compared with 82 in the fourth quarter of 2016 and 84 in the first quarter of that year. No companies entered receivership, which was also the case in three of the four quarters of 2016.

In the 12 months to the end of March 2017, an estimated 1 in 213 active companies (or 0.47 per cent of all active companies) went into liquidation, up slightly from 1 in 215 in the 12 months to the end of 2016, and 1 in 234 in the 12 months to the end of March 2016. This rise in liquidation rates has been mainly due to the one-off increase in creditors' voluntary liquidations in the fourth quarter of 2016.

Copies of *Insolvency Statistics – January to March 2017 (Q1 2017)* can be downloaded from the Government website at *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/611370/Q1_2017_statistics_release_-_commentary.pdf* [Accessed 21 June 2017].

NEW REGULATIONS ON STATUTORY AUDITORS AND THIRD COUNTRY AUDITORS

The Statutory Auditors and Third Country Auditors Regulations 2017 (SI 2017/516) came into force on 1 May (apart from reg.13(4)(b)).

The Regulations implement certain requirements of the EU Directive 2014/56 amending the Audit Directive 2006/43 (see (2016) 386 Co. L.N. 4) in respect of friendly societies and syndicates in the Lloyd's insurance market, and make further changes to UK law in respect of friendly societies to give effect to the Audit Regulation 537/2014 (see (2016) 386 Co. L.N. 4).

In addition, they make certain amendments to the Statutory Auditors and Third Country Auditors Regulations 2016 (SI 2016/649) and to provisions inserted by that instrument into the Companies Act 2006 and the Building Societies Act 1986 to improve the clarity of those provisions and ensure consistency of the legislative provisions relating to the entities concerned.

See P.C.L. para.16.110; B.C.L.P. ¶61-110.

FRC PRE-EMPTION GROUP ISSUES MONITORING REPORT

The Pre-Emption Group of the Financial Reporting Council (FRC) released a monitoring report on 12 May that looks at the implementation of the Statement of Principles and the template resolutions.

The Group published the latest version of the statement, which outlines the principles to be taken into account when considering the case for disapplying pre-emption rights, in March 2015 (see (2015) 370 Co. L.N. 6). The template resolutions, which outline good practice in requests for disapplication, were published in May 2016 (see (2016) 384 Co. L.N. 5).

The Group found that over the course of the year, the template resolutions and Statement of Principles have generally been followed. However, it also came across possible examples of poor consultation or disclosure. To help with this, the Group has published an *Appendix of Best Practice in Engagement and Disclosure*. The appendix reiterates the group's view that engagement must address both the spirit and letter of the Statement of Principles. It states that consultation about proposed issuances must be specific and unequivocal, and the topic of whether or not pre-emption authority is to be utilised must be explicitly addressed.

Copies of *Pre-Emption Group Monitoring Report May 2017* (this includes the *Appendix of Best Practice in Engagement and Disclosure*) can be downloaded from the FRC website at *https://www.frc.org.uk/FRC/media/Documents/May%202017/170512-PEG-monitoring-report.pdf* [Accessed 21 June 2017].

See P.C.L. para.5.832; B.C.L.P. ¶20-770.

EU GOVERNMENTS APPROVE PROSPECTUS REGULATION

The European Council, which represents EU Member State governments, adopted the Prospectus Regulation on 16 May.

The European Parliament approved the text on 5 April 2017 following an agreement between the Council and Parliament representatives on 7 December 2016 (see (2017) 391 Co. L.N. 5). Most provisions will apply 24 months after entry into force which will be on the twentieth day following that of its publication in the Official Journal of the European Union, when the Regulation will also be given an official number.

The Regulation will replace Directive 2003/71 and sets out to simplify administrative obligations related to the publication of prospectuses. The reform was proposed by the Commission on 30 November 2015 (see (2016) 379 Co. L.N. 4) as part of its Capital Markets Union Action Plan (see (2015) 377 Co. L.N. 4).

See P.C.L. para.16.130; B.C.L.P. ¶17-575.

AMENDMENTS TO SHAREHOLDERS' RIGHTS DIRECTIVE NOW IN FORCE

The Directive (2017/828) amending the Shareholders' Rights Directive 2007/36 was published in the *Official Journal* of the European Union on 20 May.

It is in force from 9 June 2017 and must be implemented by EU Member States by 10 June 2019—by which time the UK will no longer be a Member State. The UK may choose a reciprocal Treaty or other arrangement under the Brexit negotiations.

The final text of the Amending Directive is in substantially the same form as the version approved by the European Parliament in March 2017 (see (2017) 394 Co. L.N. 6).

Copies of Directive 2017/828 can be downloaded from *http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L0828&from=EN* [Accessed 21 June, 2017].

See P.C.L. para.16.148.1; B.C.L.P. ¶1-400.

BRUSSELS LAUNCHES PAN-EU BUSINESS REGISTER

The European Commission launched a single platform to access company information in the EU on 9 June.

With an increasing number of cross-border businesses using the opportunities offered by the Single Market, the Commission says, the demand for access to information on

companies with businesses in different Member States has increased. Up to now, information on companies has had to be requested separately from the diverse national registers, through often lengthy and costly procedures.

The service has been set up in close co-operation between the Commission and EU Member States under the Directive on interconnection of EU business registers.

Linking national business registers will facilitate cross-border trade and increase confidence and transparency in the EU single market, said Commissioner Věra Jourová.

The business register search is available at *https://e-justice.europa.eu/content_find_a_company-489-en.do?m=1* [Accessed 21 June, 2017].

See P.C.L. para.2.314; B.C.L.P. ¶3-300.

RECENT CASES ROUND-UP

A paragraph number in or following an item refers to a commentary paragraph in Palmer's Company Law (P.C.L.) or in British Company Law and Practice (B.C.L.P.).

COURT WOULD NOT REWRITE ARTICLES BUT DID ORDER COMPANY MEETING IN ABSENCE OF A DIRECTOR

The Companies Court has considered a claim by minority shareholders of a company for a declaration as to the voting rights of the company's members and an order under s.306 of the Companies Act 2006 convening a meeting of the company.

The company had been established in 1988 to maintain and manage a private residential street of 30 houses. Under its articles of association, each house owner was to have a shareholding and equal voting rights. The developer sold four houses and allotted two shares to each. The first defendant, "S", bought the remaining 26 houses. S sold all but one house but retained most of the corresponding shares. S owned 50 shares; the claimants owned six. Article 10(a) of the articles provided that each member had only one vote at general meetings, regardless of how many shares they held. Article 11(d) provided that only members of the company could act as a director. S's owner purported to act as the company's sole director, although he did not own a house in the street and was not a member. In September 2016, the claimants complained to S about its failure to transfer the shares. In November, S caused the company to circulate a written resolution which would delete the provisions of the articles with which the claimants complained that S had failed to comply, and would remove the requirement for a director also to be a shareholder. S used its majority shareholding to pass the resolution. The claimants considered that the resolution had not been validly made, or a meeting of the company should be held to consider reversing it.

The claimants argued that (1) although s.284 provided that members had one vote per share on a vote on a written resolution, that was displaced by the provision in art.10(a) for one vote per member; although art.10(a) only referred to general meetings, not written resolutions, it had been drafted before the Companies Act allowed for majority votes on written resolutions, so it should be construed as making provision for the written resolution procedure as well as for general meetings; (2) an order under s.306 should be made on the ground that it was impracticable for the members to call a meeting, since there was no director in place to be required to call a meeting under s.303(1).

The deputy judge acceded to the second part of the claim. On voting rights he held that when construing constitutional documents such as articles of association, the court was entitled to look at subsequent changes in circumstances. However, that approach did not permit the court to rewrite the wording so as to extend it beyond its natural meaning. Where the parties had used unambiguous language, the court had to apply it. It was clear that art.10(a) did not apply to written resolutions. On s.306, S's owner was ineligible under the original articles to be the company's director because he did not own a house in the street. Even if the November resolution was effective, there would have to be a fresh appointment or ratification after the alteration of the articles. There had been no ratification. The owner had not been validly appointed as director. The company therefore had no directors. In those circumstances, it was appropriate for the court to make an order under s.306.

Puzitskaya v St Paul's Mews (Islington) Ltd [2017] EWHC 905 (Ch).

Judgment delivered 26 April 2017.

See P.C.L. para.7.515; B.C.L.P. ¶48-200.

ON INTERPRETATION OF ARTICLES VALUATION OF SHARES IN PRE-EMPTION NOT DISCOUNTED FOR MINORITY

The Court of Appeal has heard an appeal by two companies against a judge's interpretation of provisions in their articles of association relating to the transfer of shares.

The companies were owned by eight shareholders, all of whom were involved in the management of the companies. Control of the companies was finely balanced. The articles of both companies restricted the right of shareholders to sell their shares and granted pre-emption rights to other shareholders. Under art.5, the other shareholders could purchase the relevant shares at a "prescribed price" which, in default of agreement, would be determined

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by independent accountants. If the shares were not taken up at that price by the other shareholders, their owner could transfer them "to any person at any price (not being less than the prescribed price)". The respondents were minority shareholders and wished to sell their shares. A dispute arose concerning the valuation. The companies issued proceedings seeking determination of agreed questions about the pre-emption provisions in art.5. The judge found largely in favour of the respondents, holding that the accountants had to conduct their valuations on the basis of a pro rata proportion of the value of the whole equity of each company, rather than on the basis of the price which might be achieved for the shares given their status as a minority shareholding. The issues for the court were the correct basis of valuation and whether the "any person" to whom the vendor could transfer the shares was restricted to a natural person so as to exclude a corporate transferee.

In dismissing the appeal, Henderson LJ decided that the judge had determined the correct basis of valuation. The companies argued that the starting point in English law was a presumption in favour of a construction which put a realistic value on the shareholding, rather than a construction favouring an artificial value based on the overall value of the company as a whole. There was no presumption one way or another. It was far from obvious, particularly in the case of a private company with few members where the relationship between the key shareholders was one of quasi-partnership, that valuation of the shares to be transferred would accord with business common sense. The parties might well have intended the valuation to reflect the value of the vendor's proportional stake in the business as a whole, regardless of the size of his shareholding. There was no substitute for looking at the language actually used in order to ascertain what the parties intended. The starting point was the definition of the "prescribed price" because that was the only place where the nature of the exercise to be performed by the accountants was stated. The prescribed price was stated to be such sum "per share" according to valuation of the company on a going concern basis. The reference to a going concern had to mean valuing the company as a whole. Once that value had been found, the prescribed price would be calculated by ascertaining a price per share on a pro-rata basis. The language pointed clearly away from valuing the shares to be transferred as a block. It only made sense if the value per share was derived from the value of the company as a whole. Ordinarily, the word "person" included a corporation. However, art.5G of the articles gave the company the right to sell "to any person or company of whom or which ... it shall approve". The words "of whom or which" indicated that the differentiation was clearly intentional because the draftsman had had inanimate corporations in mind. The provision enabling the company to sell the shares to "any person" was art.5L. It was not appropriate to carry the art.5G distinction forward into art.5L, so that the words "any person", which would normally be unrestricted, were, by implication, confined to natural persons. Much clearer language would be needed to restrict the normal meaning of "any person", given the general principle that shares, as items of personal property, were prima facie freely transferable.

Cosmetic Warriors Ltd v Gerrie [2017] EWCA Civ 324.

Judgment delivered 5 May 2017.

See P.C.L. paras 6.467, 8.3823; B.C.L.P. ¶22-720, ¶41-450.

DIRECTOR WAS IN BREACH OF DUTY AND COULD NOT BE EXCUSED LIABILITY

The Chancery Division has considered a claim by a company in liquidation against its former director and sole shareholder for breach of duty and sought the return of money allegedly held by him on constructive trust, while he denied liability but asked to be excused any liability.

The defendant former director had agreed to buy a company, "B", which ran plumbing training courses. The claimant was incorporated and purchased B's issued share capital. The defendant became the claimant's sole shareholder and director of both companies. B went into administration, but on the same day its business was sold to two new companies incorporated on the defendant's instructions, in a pre-pack administration arrangement. The defendant claimed that he had been advised to do so by B's liquidator. Shortly before the sale, B made payments to the claimant of £1,013,000. The claimant then paid £808,000 to the two new companies. B's liquidator brought a claim against the defendant for damages for misfeasance and breach of fiduciary and statutory duty, alleging that the claimant had paid the defendant for his own benefit. The defendant contended that the payments had properly been made to the new companies to run their businesses. That action was settled. In the instant claim, three further payments made to the defendant from the claimant's bank account, totalling £850,299, were in issue. The defendant claimed that the claimant's liquidator, who had also been B's liquidator, had already sued him for the final three payments in the other action, and that in any event, even if his actions amounted to a breach of his duties to the claimant, he had acted honestly and reasonably and ought fairly to be excused under s.1157 of the Companies Act 2006.

The deputy judge gave judgment for the claimant. The defendant was a trustee, for B, of the money paid from B to the claimant. The claimant itself became a constructive trustee of the money for B when it received it, by virtue of knowing receipt, because the defendant knew the status of the money and was the claimant's controlling mind. The claimant took the money on trust for B and became liable to account to B for the money, which was not available to the claimant or its creditors. The last payment from B to the claimant's account was in March 2010. After that, money left the account until August 2010 when the balance was £850,299. The next three payments were those at issue, and they reduced the balance to zero. The rules of tracing through a mixed fund, which applied where funds held in breach of trust were mixed with the trustee's own money, applied in determining whether the payments were made with B's money. It was argued that the claimant's own money must have been paid out first, leaving B's money in the account for as long as possible. However, after the last payment in from B, the account balance fell below the £850,299 paid out in the final three payments. At its lowest point the balance was £559,812. In accordance with the tracing rules, that balance belonged to B and could not be claimed by the claimant. Of the money claimed in the action, £559,812.49 was B's, so to that extent the final three payments, whether or not made in breach of duty to B, were not made in

breach of duty to the claimant. Only the claimant's money could be claimed in the instant action, so its claim was limited to £290,486. The defendant had regarded the claimant as a conduit and had given no thought to it as a separate corporate entity. He had focused on the business and not the separate identities of the claimant, B and himself, but they were three persons, and the payment of the claimant's money for the sake of B's survival was a breach of his duty as the claimant's director and as trustee of its money. The defendant's honesty under s.1157 was not challenged, only the reasonableness of his actions. He said he had acted on the liquidator's advice and instructions throughout, and with his full knowledge. However, the court found that the pre-pack administration became the defendant's preferred option as a result of his own thinking, following discussions with the liquidator. It was not true that the liquidator instructed the defendant to take that course. Responsibility for choosing the pre-pack administration rested with the defendant. The liquidator knew of the transfers from B to the claimant's account, and there was no evidence that he had expressed disapproval, but he had not known the amounts being transferred until later. There was no evidence that he knew anything about the final three payments or approved them. Responsibility for those payments rested with the defendant. As to whether the money was spent as the defendant claimed, the new companies' offices had required new fittings, and that work had been done, but there was no evidence as to its value. There was therefore no evidence as to whether the final three payments were reasonable. The defendant could not blame the liquidator: he had been the director of many companies and must have known directorship carried special responsibilities. The liquidator had not given unequivocal advice or approval, and the amount of the payments could not be objectively justified. The s.1157 defence failed. The defendant was liable for breach of duty and had to account for £290,486.

Chard Hunt Investments Ltd v Hunt [2017] EWHC 988 (Ch).

Judgment delivered 12 May 2017.

See P.C.L. para.8.3425; B.C.L.P. ¶32-950.

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