Neutral Citation Number: [2019] EWHC 1566 (Ch)

Case No: HC-2017-002760

**IN THE HIGH COURT OF JUSTICE**
**BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES**
**BUSINESS LIST (ChD)**

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 19/06/2019

**Before**:

**THE HONOURABLE MR JUSTICE ZACAROLI**

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**Between:**

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| **(1) Burnden Holdings (UK) Limited (In Liquidation)**<br>**(2) Stephen John Hunt (As Liquidator of Burnden Holdings (UK) Limited)** | **Claimants** |
| **- and –** | |
| **(1) Gary John Fielding**<br>**(2) Sally Anne Fielding** | **Defendants** |

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**Christopher Parker QC and Caley Wright** (instructed by **Enyo Law LLP**) for the **Claimants**
**James Potts QC and Matthew Parfitt** (instructed by **Addleshaw Goddard LLP**) for the **Defendants**

Hearing dates: 27, 28 February, 1, 4, 5, 6, 7, 11, 12, 13, 19, 21 March 2019. Further written submissions 21 and 27 March 2019

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# Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR JUSTICE ZACAROLI

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**Mr Justice Zacaroli:**

# A. Introduction

1. In the summer of 2007 Mr and Mrs Fielding were the majority owners of the Burnden group of companies (the "Group"). Between them they held all of the A ordinary shares and B ordinary shares (comprising 78% of all of the issued share capital) of the Group's holding company, Burnden Holdings (UK) Limited ("BHUK"), the first claimant in this action. The remaining shares (consisting of D ordinary shares) were owned by Mr Ian Whitelock (a director of various companies in the Group), Mr Stephen Beckett (the finance director of the Group companies) and the trustee of an employee share scheme. BHUK was placed into administration on 2 October 2008. A compulsory winding-up order was made against it on 7 December 2009.

2. The directors of BHUK were Mr and Mrs Fielding, Mr Whitelock, Mr Beckett and a Mr Eamon Kavanagh.

3. This action, commenced upon issue of a claim form on 15 October 2013, is brought by BHUK and by its liquidator (the second claimant, Mr Stephen Hunt) against Mr

and Mrs Fielding, alleging breach of fiduciary duty in respect of two transactions effected by BHUK in 2007. The first was the execution of a fixed and floating charge in favour of the Fieldings as security for loans made by them (the "Grant of Security"). The second was a transaction by which a subsidiary of BHUK known as Vital Energi Utilities Limited ("Vital") was demerged from the Group (the "Demerger Transaction"), involving a distribution in specie by BHUK of the entire shareholding in Vital (the "Distribution"). The Grant of Security was dated 9 July 2007. The Distribution was effected on 12 October 2007.

4. The business of the companies in the Group, apart from Vital, was the manufacture and sale of conservatories and parts for conservatories, using the trading style "K2". Vital's business was construction consultancy in the combined heat and power sector.

5. BHUK was parent to a number of subsidiary companies, including K2 Conservatory Systems Limited ("K2 Con"), K2 Glass Limited ("K2 Glass"), Cestrum Conservatories Limited ("Cestrum"), SGI Tooling Limited ("SGI"), The Burnden Group Plc ("TBG") and Vital.

6. Of these, by 2007 K2 Con, K2 Glass, Cestrum and Vital were the principal trading companies in the Group. TBG was dormant, having transferred its business to K2 Con as of 1 July 2005 (although the transaction was in fact not finalised until about September 2006). SGI had been dissolved in 2003, its business having been acquired by TBG in 2001.

7. The Burnden Group and the Fieldings were (with others, including certain other Group entities) defendants in a long-running dispute with Ultraframe (UK) Limited, a competitor to the Group. This culminated in a trial commencing on 11 November 2004. In a judgment handed down on 27 July 2005, Lewison J found almost entirely for the defendants. Between them, the Fieldings and certain Group companies had spent many millions of pounds on the litigation. In a ruling dated 7 October 2005, Lewison J awarded the defendants a substantial part of their costs of the litigation. By the time of the two transactions in question, only an interim payment of £1.84 million had been received. The precise further amount which the defendants (and particular entities within the Group) could reasonably expect to recover is in dispute, but they in fact subsequently recovered only a further sum (before deduction of substantial costs) of £1.58 million, in February 2008.

8. By the spring of 2007, the Group was facing a severe cash crisis. This was anticipated to be critical by the winter of 2007/2008. The Group was accordingly looking for ways to generate cash. The demerger of Vital was identified as a potential solution. Ultimately it was structured by way of the Distribution followed by a sale of 30% of the shares in Vital to a third party, Scottish and Southern Energy PLC ("SSE"), for £6 million, with £3 million of the sale proceeds then being loaned to the Group by the Fieldings.

# B. The claimants' claims in outline

9. The claimants contend, in relation to the Distribution, that:

   i) There was in fact no declaration of a dividend, because no valid board meeting of BHUK ever took place at which the relevant matters required by Part VIII

of the Companies Act 1985 (the "1985 Act") were actually considered and a decision actually made;

ii) Alternatively, the Distribution was unlawful because the requirements of the 1985 Act were not met (in that the relevant accounts did not enable a reasonable judgment to be made as to the assets, liabilities, profits and losses of the company and there were in fact insufficient distributable reserves) and it was therefore made in breach of fiduciary duty by the defendants as directors of BHUK. The claimants contend that once it is established that the Distribution was unlawful, the defendants are strictly liable for breach of fiduciary duty as directors. The defendants contend that liability is fault-based.

iii) The Distribution was effected by the defendants in dishonest breach of their fiduciary duties under s.172(3) of the Companies Act 2006 (the "2006 Act") because either at the time of the Distribution or as a result of it they knew that BHUK was insolvent or likely to become insolvent and they failed to take account of the interests of BHUK's creditors. The claimants made it clear, in the course of their opening submissions at trial, that this claim is advanced solely on the basis that the defendants were dishonest, in that they actually knew that BHUK was, or was likely to become, insolvent. No alternative claim is pursued that the defendants ought to have known (on an objective basis) that BHUK was or was likely to become insolvent; and

iv) The Distribution was a transaction defrauding creditors within the meaning of s.423 of the Insolvency Act 1986 (the "1986 Act").

10. In relation to the Grant of Security, the claimants contend that:

i) The Grant of Security was unauthorised because there was no board meeting of BHUK at which a decision was made to enter into it, alternatively there was no informed consent because the directors who authorised the Grant of Security (which did not include the defendants) were unaware that all of the lending, for which it was security, had already been advanced by the Fieldings;

ii) Alternatively, if the directors who authorised the Grant of Security knew that all of the lending had already been advanced, then those directors were in breach of fiduciary duty because the Grant of Security was of no benefit to BHUK and the defendants were aware of this, so they received the benefit of the security as constructive trustees; and

iii) The Grant of Security was a transaction defrauding creditors within the meaning of s.423 of the 1986 Act.

# C. The Witnesses

11. I heard evidence, for the claimants, from Mr Hunt. Since, however, his appointment came long after the events surrounding the Grant of Security and the Distribution, he was not in a position to give any evidence about those events.

12. For the defendants, I heard evidence from Mr Fielding, Mrs Fielding, Mr Beckett, Mr Whitelock and Mr John Joyce, the partner at Addleshaw Goddard who advised the Group in relation to the Distribution.

13. Many of the issues raised by this claim concern the details of meetings and other discussions that occurred nearly 12 years ago. Generally speaking, none of the witnesses had an independent recollection of those details. This is unsurprising given the passage of time and given that, as the action was not commenced until six years after the Distribution, they would have had no reason to recall the events until six years after they occurred.

14. Where the witnesses did purport to describe matters of detail, I find that it was almost entirely a recitation of, or reconstruction from, the contemporaneous documents. On occasions this was expressly stated. On other occasions, matters apparently expressed in witness statements as recollection were accepted on questioning, or demonstrated, to be reconstruction.

15. Accordingly, I approach with caution the purported recollections of all of the witnesses on matters of detail and, as will be apparent in my consideration of the issues, I place much greater reliance on the documents.

16. As against Mr Fielding, the claimants rely on findings made by Lewison J in the *Ultraframe* proceedings that he had forged documents to present false evidence to the Court.

17. I find that Mr Fielding demonstrated a propensity to say what would be helpful to his case, on more than one occasion having to modify his evidence when shown a document which was inconsistent with what he had just said. For example, he initially maintained that the idea that only 30% of Vital would be sold came from SSE, but when shown a passage in an earlier statement of his that contradicted this he said "I appreciate I put in that statement it came from us, and its true, but it also mirrored what SSE wanted as well." I did not find him, however, to be a dishonest witness, deliberately attempting to present false evidence to the Court. Rather, I conclude that, as a result of going over the events from long ago, he had convinced himself on various points. Nevertheless, this reinforces my view that his evidence on points of detail, unless corroborated by other credible evidence, is to be given little weight.

18. Mrs Fielding had far less involvement in the critical events, being largely concerned with the day to day operations of K2 Con. She said, in her first statement, that she did not have a particularly good memory. While she attended key board meetings, she had very little independent memory of them, and gave evidence having seen the minutes which helped to 'jog' her memory.

19. I found Mr Beckett to be making a genuine attempt to assist the court. He too, however, had little recollection of the events of 2007 and a large part of his evidence was an attempt to explain events by reconstruction from documents. An important example was his attempt to explain the various references in documents to the amount of costs expected to be recovered from Ultraframe. I do not accept that he had an independent recollection of this level of detail, but consider that his explanation was an attempt to rationalise the belief he now has (having reviewed extensively the

documents) that TBG was reasonably anticipating receipt of substantial sums (which is of direct relevance to the arguments relating to the value of TBG, as I explain below at paragraph 230ff). He seemed to align himself with the defendants' 'team', responding to allegations put to him on more than one occasion by reference to what "we" had put into "our" witness statements.

20. Importantly, however, Mr Beckett came across as diligent and thorough when it came to financial matters. He had a detailed understanding of the (limited) accounting records relating to the Group that were in evidence. For example, he gave detailed and consistent explanations of the contents of the management accounts for the Group that had been disclosed by the auditors only shortly before the trial. This view of Mr Beckett as a diligent and conscientious finance director is corroborated by the contemporaneous documentation which has survived from 2007.

21. I found that Mr Whitelock, too, was making a genuine attempt to assist the court. I bear in mind that both he and Mr Beckett are long-standing colleagues and acquaintances of Mr and Mrs Fielding. While I find that this led them to associate themselves with the case for the defence, I do not believe that this led either of them to attempt to fabricate their evidence.

22. I address Mr Joyce's evidence in more detail at paragraph 59 and following below. In summary, however, I am satisfied that he was an honest witness, also genuinely attempting to assist the court, albeit with little recollection of the events in question.

23. Where the defendants' witnesses dealt with broader questions, such as knowledge of the general financial position of the Group at the time, then I accept that the witnesses were more likely to be relying on actual recollection. In their statements provided at an early stage of these proceedings – before any disclosure had been obtained from the auditors – they described the extent to which they had engaged with and relied on the Group's auditors. This evidence was substantially corroborated by the documents obtained from the auditors very shortly before trial, as I explain below.

24. Each side also presented expert accountancy evidence relevant to the requirements of the Interim Accounts, the solvency of BHUK and the valuation of Vital. I comment on specific elements of the expert evidence as and when relevant throughout this judgment. At this stage, I confine myself to some general comments about their evidence.

25. The claimants' expert, Mr Jeffrey Davidson, was the subject of trenchant criticism from the defendants. Some of that criticism was justified, in that there were important respects in which he had failed to correct errors, or update matters, in his written reports in light of information which subsequently came to light until the points were raised in cross-examination. However, I do not accept that he failed to comply with his overriding duty to help the court, or that he refused to concede the obvious where it was contrary to his client's interests or that he should be criticised personally for production of his fourth report on the basis that it was inappropriate advocacy. My principal ground for refusing to admit that report into evidence was that, while it was a helpful collation of material relating to the Group's accounting for the Ultraframe costs, it did not constitute expert opinion evidence. I do not, however, criticise Mr Davidson for having complied with a request from the claimants to produce the document.

26. I also reject the defendants' criticism that Mr Davidson failed to take into account the views of the Group's auditors when considering, for example, the solvency of BHUK or its subsidiaries. It was suggested that in doing so, he had failed to take into account contemporaneous evidence. I disagree. He was instructed to provide his own opinion as to the solvency of the companies. Conclusions which might be drawn from what the auditors said or did at the time are matters of evidence for the court to take into account, but they are not contemporaneous materials relevant to the experts' opinion of solvency.

27. For the same reason, the tendency of the defendants' expert, Ms Annette Barker, to justify her conclusion on a number of points by reference to the fact that the Group's auditors must have satisfied themselves on various points, for example because they signed off on accounts of the various companies on a going concern basis, was of limited assistance.

28. As I develop later on in this judgment when addressing the detail of the claims, my main criticism of the substance of Mr Davidson's evidence is that, on a number of valuation issues (for example, valuing BHUK's equity and debt interests in its subsidiaries), he did not take account of contemporaneous evidence relating to the future trading prospects of those subsidiaries, but limited himself to a snapshot of the net asset position at the relevant valuation date.

# D. The Documentary Record

29. The task of fact-finding in this case is made more difficult by the limited contemporaneous documentation available.

30. Between the events in question and the commencement of proceedings the Group had been through administration, liquidation and two pre-pack sales. In 2012 the business was sold to a competitor, at which point three of the five servers containing electronic records of the Group were wiped and the remaining two were transferred to the purchaser. The Distribution was by then five years in the past, and the directors would have had no reason to retain records relating to it. All of the Group's underlying accounting information, previously held on Navision software, is no longer available.

31. In those circumstances, the documents that have survived are largely those that were communicated with third parties, in particular solicitors, accountants and financial advisors. It is for this reason that board minutes relating to the Grant of Security and the Distribution have survived.

32. The Group's auditors were Tenon Audit Limited ("Tenon Audit"), while Tenon Corporate Finance Limited ("Tenon CF") were finance and tax advisors to the Group (together, "Tenon"). As I will describe in more detail below, Tenon CF were closely involved in the Demerger Transaction. Moreover, Tenon Audit were working closely with the directors, and in particular Mr Beckett, in connection with the audit of the Group's financial statements for the year ended 30 June 2007 at around the same time as the Distribution. The liquidator obtained documents from Tenon CF in 2014.

33. Although requests had been made for documentation from Tenon Audit at an earlier stage, the claimants made little, if any, effort to ensure compliance with such requests. It was not until the end of 2018 that any documentation was obtained from Tenon

Audit. Even then only a handful of papers were provided. Very shortly before trial, Tenon Audit provided approximately 100 further documents. These still represent only a relatively small proportion of the totality of documents that Tenon would have had at the time.

34. The defendants, and Mr Whitelock and Mr Beckett, maintain that there were regular board meetings, with detailed financial information circulated to the board for such meetings, every month. The only minutes of such meetings that have survived, however, are those of 2 May 2007 and 1 June 2007. I accept the evidence of the defendants' witnesses that there were such regular board meetings and that detailed financial information, including cashflow and other forecasts, were made available to the directors at the time. The very late disclosure from Tenon Audit includes some such material, in particular numerous spreadsheets prepared in about December 2007 containing management accounts, including forecasts, for every company in the Group. These refer to other, much more detailed, forecasts which have not survived. I find it highly unlikely, given the diligence which I believe Mr Beckett brought to his job, that these management accounts were a one-off.

35. There is a dispute as to whether one of these regular board meetings was held at the end of September 2007. I address that at section E5 below.

# E. The Distribution

## E1. The outline of the Demerger Transaction

36. The demerger of Vital was achieved pursuant to the following steps:

i) Three new companies were incorporated: BHU Holdings Limited ("BHUH"); Vital Holdings Limited ("VHL") and Burnden Group Holdings Limited ("BGHL"). BHUH was owned by the existing shareholders in BHUK in the same proportion that they had held their shares in BHUK;

ii) On 4 October 2007, the existing shareholders transferred all of their shares in BHUK to BHUH (thus inserting BHUH as an intermediate holding company between the existing shareholders and BHUK);

iii) On 12 October 2007, BHUK's 100% shareholding in Vital (comprising a sole share) was distributed to BHUH as a dividend in specie;

iv) On 15 October 2007, BHUH entered into a members' voluntary liquidation. The liquidator of BHUH sold the sole share in Vital to VHL in exchange for the allotment by VHL of shares to BHUH's shareholders. VHL was therefore owned by the existing shareholders in the same proportion as they held BHUH (and, before that, BHUK).

v) On the same date, the liquidator of BHUH also sold the shares in BHUK to BGHL in exchange for the allotment by BGHL of shares to BHUH's shareholders. BGHL was therefore owned by the existing shareholders in the same proportion as they held BHUH.

vi) The ultimate effect was that Vital was wholly owned by VHL and the rest of the Burnden Group was owned by BGHL, and both VHL and BGHL were owned by the existing shareholders in the same proportion they had previously owned shares in BHUK.

37. On 19 October 2007, Mrs Fielding sold shares amounting to 30% of VHL's share capital to SSE for £6 million.

38. Shortly after that, Mrs Fielding loaned £3 million to the Burnden Group.

## E2. The origin and development of the Demerger Transaction

39. In this section, I record the genesis and development of the Demerger Transaction, identifying the roles played by professional advisors at each stage, as revealed primarily by the contemporaneous documents, many of which come from disclosure provided by Tenon. To the extent that there is any issue over aspects of this history, the following paragraphs constitute my findings in this respect.

40. The demerger of Vital had been in the contemplation of the directors of BHUK since at least the early part of 2007. Mr Whitelock, who was a director of Vital and of BHUK, said in his witness statement that the genesis of the idea was that not only was Vital's business different to that of the rest of the Group, but the two businesses had quite different market cultures, with diverging futures and no synergies. It was felt that Vital's business suffered by association with the conservatory business of the rest of the Group. Mr Fielding's evidence was to the same effect, albeit the more detailed reasons articulated by Mr Whitelock (as explained in the next paragraph) were more compelling.

41. Mr Whitelock's evidence in his witness statement was that Vital had experienced difficulties in attracting staff during 2006 and 2007, that the directors recognised the importance of keeping key staff, and that a share option scheme would be an attractive thing to offer employees. This was difficult, however, while Vital remained part of the Group. I accept this evidence, which Mr Whitelock repeated in the witness box, because it is consistent with the explanation provided by Mr Kitson of Tenon to HMRC in a letter of 9 August 2007 when seeking tax clearance for the Demerger Transaction. In describing the rationale for the transaction Mr Kitson explained that Vital had no synergy with the other businesses in the Group, that it wished to incentivise key management and seek external investment, and that it was unable to achieve either of these while it was part of the Group. Contrary to the claimants' suggestion that there was no need for Vital to be demerged in order for a share incentive scheme to be offered, the letter went on to explain that under the current structure shares would need to be offered by BHUK, but this would mean that the employees would benefit not only from growth in Vital but also in the value of Burnden, over which they had no involvement or influence.

42. By May 2007, however, a further incentive for the disposal of Vital emerged, namely the need to generate cash within the Group given its short to medium term cash-flow problems.

43. The minutes of the meeting on 2 May record Mr Beckett reporting on the financial results of the Group, as follows:

i) The Group had achieved only the worst-case financial targets for February and March 2007 and more pessimistic re-forecasts had been prepared for April to June. These reflected lower confidence in the recovery of K2 Con, a fall off in core business from B&Q at Cestrum and a reduction in Vital's sales as a result of delays in achieving forecast project commencement and completion dates.

ii) The cash position of the Group had deteriorated. It was reported to be very tight for the next two months, but should then recover as Vital's cashflow improved and it became possible to "back off on overseas purchases of aluminium". This was a reference to the fact that although aluminium could be purchased more cheaply from China, that was bad for cashflow as it was necessary to pay upfront. Mr Beckett's evidence was that this was one of the measures taken to address cash flow issues. The claimants sought to discredit Mr Beckett's evidence on this point by producing (after Mr Beckett had concluded his evidence) a table showing purchases of Aluminium from China in 2007 and 2008. In the absence of evidence of the total amount spent on Aluminium purchases (including from other sources) I found this table inconclusive (although I note that, consistent with the concept of "backing off", if not altogether stopping, sourcing aluminium from China, it in fact indicated a reduction in purchases from China in the middle of 2007). It would in any event be unfair to place reliance on it given that it was not put to Mr Beckett.

iii) GE (lenders to the Group, with security over the building owned by Cestrum) had expressed concern over the ongoing performance of the business outside of Vital.

iv) Although the conservatory division was forecast to make an operating profit of £723,000 for the year 2007/2008, it was felt that this was over-optimistic and that a revision was called for.

v) The forecasts having been reviewed, it was clear that the cash position was significantly worse than previously thought. It was anticipated that the position would deteriorate further during the winter, as "the conservatory division consumes a lot of cash between December and March" (reflecting the seasonal nature of that business). In light of this, the directors turned to consider ways of raising cash.

vi) The first possibility was the costs recovery from the Ultraframe litigation, but this was said to be very uncertain as to timescale and Ultraframe's willingness or ability to pay.

vii) The second was the sale of the Cestrum building. Mr Beckett reported that the Cestrum building had been valued at approximately £2m, but the agents (Knight Frank) had advised that a sale would take between six months and a year to complete.

viii) Third was the possibility of selling K2 Glass. It was felt, however, that it was the wrong time to do so, because K2 Glass was on an upward trend in terms of sales and profitability and a disposal now would not realise its full potential.

ix) The fourth was the sale of the conservatory business, but it was noted that the Group intended to restructure and combine the conservatory business into one company, and until this was done a sale would be a "fire sale".

x) The fifth option was the disposal of Vital. It was unanimously decided that this was the preferred option. Mr Whitelock and Mr Beckett were asked to prepare a sales prospectus for Vital.

44. Accordingly, a detailed business review of Vital was prepared in May 2007 (the "May Business Review"). This was prepared on the basis that all of BHUK's shareholding in Vital was to be disposed of. In fact, the only two possibilities that were seriously pursued were a management buyout (in favour of Mr Fielding and Mr Whitelock) and a sale of a part of the shareholding in Vital. I find that this was because Mr Fielding, having built up the Vital business, wished to remain involved in it, and was reluctant to do so unless he retained an ownership interest. Mrs Fielding's evidence on this point (which I accept, as it was consistent with what actually happened) was that Mr Fielding would never have sold all of Vital and that even selling a part of it "felt like he was selling himself".

45. Tenon Audit were kept fully informed, including as to the Group's difficulties. Within the recently disclosed documents from Tenon Audit, there is an agenda, and typed note, of a "pre year end meeting" held on 18 May 2007. Mr Beckett (and, for the latter part of the meeting Mr Martin, who worked with Mr Beckett) attended on behalf of the Group, and Mr Moss, Mr Duffy and Mr Ratten attended from Tenon Audit. The Group's poor performance was discussed, as were the measures being taken to cut costs (with those already taken intended to take £800,000 out of overheads). The proposal to combine the conservatory business into one entity was noted, as was the possibility of selling Vital.

46. Although the detailed forecasts produced at this time are not in evidence, these were discussed with Tenon at this meeting, it being noted that cash was tight, that business was picking up in the fourth quarter and that Cestrum would become very cash generative (noting a very beneficial relationship with a company called Apple Panels).

47. Also discussed was the deferral of VAT, it being noted that proposals in relation to K2 Glass had been accepted, but those in relation to other companies had been rejected. Mr Ratten is reported to have "explained insolvency rules". This is further explained in the minute of the board meeting of 1 June 2007, to which I refer below.

48. The third item on the agenda was "key audit risks", including recoverability of intercompany debtors and goodwill carrying value. Against the former, someone noted in manuscript "US, C UK", presumably referring to the Canterbury subsidiaries incorporated in the UK and the US.

49. The minutes of board meeting of 1 June 2007 repeated much of the matters set out in the note of the meeting of 2 May. In particular, Vital's importance to the Group was recognised, the minutes noting that "As long as there is continuing support from Vital to the rest of the group then the cash balance ought to be satisfactory". That, however, did not mean that Vital needed to remain within the Group, as it was also noted that "the ongoing potential disposal of Vital should substantially boost the

group's cash balance and alleviate any potential difficulties in the next twelve months."

50. These minutes also explained the reference in the notes of the meeting of 18 May 2007 with Tenon, to insolvency advice having been received. It was first noted that although the original application to defer payments of VAT in K2 Con had been rejected, Mr Beckett had appealed the decision, and the deferred amount was being paid in accordance with the suggested payment plan. HMRC had alleged that K2 Con was trading while insolvent, so Mr Beckett had consulted with an insolvency practitioner from Tenon, and discussed the cash flow projections and business plan with him. Tenon had commented that although there was "a technical breach of the insolvency act because of negative net worth, this would become positive if the company recognised the likely outcome of the legal action, i.e. receipt of circa £3.6 million in its financial statements."

51. The minutes also noted that Tenon commented that the cashflow projections and the Group's recovery plan (which are not in evidence) appeared to be robust. It is apparent from other items in the minutes that the recovery plan encompassed various steps designed to reduce costs. One of those was the amalgamation of Cestrum into the sites occupied by K2 Con, anticipated to achieve overhead savings of £1 million.

52. There is also in evidence a one-page document, with Mr Beckett's name typed at the bottom above the date 22 June 2007, entitled "Any Other Business". It refers to the fact that there was to be tabled for the approval of the board a new loan agreement and debenture (relating to the Grant of Security) and a valuation of Vital prepared by Tenon CF "with a view to the potential disposal of Vital Energi for a consideration of £6.4 million. This could significantly improve the overall cash position of the remaining group." The document also refers to proposals for simplifying the accounting structure for certain subsidiaries. On 21 June 2007 Mr Beckett circulated by email to all of the directors of BHUK a copy of the Tenon CF valuation of Vital which he asked them to read "in preparation for a discussion at the [BHUK] board meeting on Wednesday". The next Wednesday was 27 June 2007. The board minute that has survived from that date deals only with the Grant of Security. It is one of a series of 'pro forma' minutes in similar form for each of the companies that were involved in the Grant of Security. I infer, from the "Any Other Business" document, and Mr Beckett's email of 21 June, that there was a wider discussion at a meeting of the board of BHUK on 27 June 2007, but that no minute of that discussion has survived.

53. A single page, out of the cash flow and other forecasts that were available to the directors from this time, has survived. This is headed "Summary of monthly bank balances per company – cash book balance", and relates to the year from July 2007. In the top section of the document, apart from December 2007 and January 2008, positive cash balances are forecast for the Group as a whole, leading to a positive cash balance of £3.273 million by June 2008. The figures are substantially bolstered, however, by those for Vital. Without the cash balance for Vital, for example, in most months the overall Group position would be negative.

54. In the middle section of the document, the summary of monthly bank balances is exhibited by division (i.e. showing the position separately for the conservatory division and for Vital). This shows a positive balance for Vital throughout the year,

but a negative balance for the conservatory division until June 2008, when a positive balance of just over £1 million is forecast for the conservatory division.

55. In the bottom section of the document, the expected cashflow from Vital is excluded as from September 2007, but replaced with a one-off injection of £3 million. This envisages that there would be a disposal of Vital on terms that £3 million of cash would be injected into the Group (as in fact happened). It also includes an injection of cash in February 2008 in the sum of £2.3 million, being the (then) anticipated sale proceeds of the building owned by Cestrum. Under this scenario the Group was forecasting a positive cash balance of £5.385 million by June 2008. The defendants point out that this forecast makes no mention of any sum to be recovered in respect of the Ultraframe costs.

56. At this time (during May and June 2007) the principal option for the disposal of Vital was a management buy-out by Mr Fielding and Mr Whitelock, financed by Co-op bank. In a letter to Addleshaw Goddard of 5 July 2007, Mr Beckett stated that the purpose was "to provide a cash injection to the rest of the group." The consideration was to be £3m in cash at completion, with a deferred consideration of £3.4 million. In addition, there was to be a waiver of the intercompany debt of £3.567 million, so the effective gross consideration was £9.967 million.

57. On the same date, however, SSE made a formal offer to purchase 30% of the shares in Vital for £6m. The offer included conditions, including total business separation between Vital and the rest of the Group, in respect of matters such as (but not limited to) shareholding, funding and inter-group guarantees, and management tie-in via suitable service contracts.

58. Mr Fielding and Mr Whitelock engaged Ford Campbell to advise on aspects of the disposal of Vital. On 10 July Mr Jeremy Carr, a corporate finance partner at Ford Campbell emailed Mr Fielding (copying, among others, Mr Joyce) presenting two broad options. The first involved the shares in Vital being demerged, with Vital raising an additional £3 million of debt which it would lend to the Group, and writing off the Group's debt to Vital of £3.5 million as part of the transaction. This was subject to HMRC clearance that there would be no adverse tax consequences. Mr Carr noted that consideration needed to be given to whether BHUK had sufficient distributable reserves (noting also that the write off of the inter-company loan might provide such reserves). A management buyout was presented as the second option, in case the first option was not possible.

59. Mr Joyce (and the other witnesses called by the defendants) said that Ford Campbell presented the Demerger Transaction as the preferred option because a disposal of Vital by way of sale would have given rise to an immediate corporation tax liability by reason of the capital gain in the value of the shares in Vital. I accept that this was a significant factor in the decision by the directors of BHUK to pursue the Demerger Transaction, rather than a sale of Vital. That is because it is evident from the contemporaneous documents I refer to in this section that the focus of the directors was on the cashflow problems faced by the Group over the coming months, and that maximising the cash to be received from the disposal of Vital was their first priority. A disposal by way of demerger that allowed for an immediate injection of £3 million by way of loan would have produced in the short term more cash than a disposal by

way of sale for an initial consideration of £3 million subject to a tax liability arising on that sale.

60. The claimants attack this decision on the basis that from the perspective of BHUK a sale was manifestly more beneficial than a demerger, because the former would have resulted in BHUK receiving substantial consideration, even taking into account a tax liability incurred on the sale, whereas the latter resulted in no consideration at all being received. They also criticise Mr Fielding, in particular, for his explanation that he was able to do this because Vital "belonged" to him, which failed to recognise corporate personality and the structure of the Group.

61. I accept that if BHUK would be rendered insolvent by the Distribution, and the defendants knew it, then structuring the disposal of Vital by way of the Distribution rather than a sale would likely be impossible to justify. However, if BHUK was solvent and would remain solvent following the Distribution, then I do not see anything intrinsically wrong with causing the disposal of Vital without BHUK receiving any value for it, particularly when BHUK was funded almost entirely with lending from the Fieldings. Where individuals structure their ownership of separate businesses through a single holding company, then provided that the holding company itself is solvent, and provided that Companies Act requirements as to distributions are complied with, it is open to those individuals to separate one of those businesses from the holding company structure and take it into their direct ownership without consideration being paid to the holding company. Whether those provisos are satisfied is one of the main issues in this case.

62. Various file notes in the documents provided by Tenon CF show that it was closely involved in the proposed Demerger Transaction throughout July 2007. As I have noted above, it was Tenon CF that sought clearance from HMRC in relation to the demerger.

63. Mr Joyce, of Addleshaw Goddard, was also closely involved with developments. On 13 August 2007, he emailed Mr Fielding, having seen that the clearance application to HMRC referred to Vital being distributed by BHUK to a new company. He asked whether BHUK had got distributable profits sufficient to permit that distribution. Mr Fielding forwarded that request to Mr Kitson at Tenon CF. Mr Kitson responded on 16 August 2007, copying Mr Duffy of Tenon Audit. He noted that as at 30 June 2006 BHUK did not have sufficient profits, "because the P&L account then stood at £604,243, negative". He recommended that Mr Fielding use Addleshaw Goddard for the legal work on the transaction. On the same date, Mr Kitson emailed Mr Beckett with Tenon's expected costs "for undertaking tax planning on the demerger". These came to £19,150. He pointed out that, in addition, there would be Addleshaw Goddard's costs and a liquidator's costs.

64. On 17 August 2007 Marion Brewer of Tenon CF emailed a proposed steps plan for the Demerger Transaction to Mr Fielding, copying in Mr Joyce, Mr Beckett and Mr Kitson. The plan identified the parties responsible for the various steps. Step 4 was the transfer of Vital which at this stage still envisaged two options: first, the demerger "if there are sufficient reserves in [BHUK] if not consider creating sufficient reserves"; and second, the transfer of the shares by way of intercompany transfer with the amount owing left outstanding, securitised and then written off. The responsibility for the dividend in specie was divided between Tenon and Addleshaw

Goddard. In her email she noted that "John Joyce will need to consider the work he needs to do in respect of the step plan".

65. On 20 August 2007, Ms Brewer emailed Mr Beckett (copying Mr Fielding, Mr Moss of Tenon Audit and Mr Joyce) to explain her understanding of the extent of distributable reserves in BHUK as at 30 June 2007. She understood that there was a retained loss of £37,000. She also noted that to allow a dividend in specie of Vital there needed to be £750,000 of reserves (because that was the carrying value of the investment in Vital), so that a dividend of at least £787,000 would need to be paid up from either K2 Glass or Vital (both of which had sufficient distributable reserves). On 21 August 2007 Mr Beckett replied pointing out that BHUK in fact had retained profits of £565,880 as at 30 June 2007, because a £600,000 provision in respect of a loan to Canterbury UK, which on Ms Brewer's figures had been included as a loss in the year 2006-2007, had already been made in the prior year accounts. He also pointed out that BHUK was budgeted to make a loss of £4.7k per month for the first five months of 2007-2008.

66. On 22 August 2017, Mr Joyce emailed Mr Fielding and Mr Beckett in relation to Ms Brewer's email referring to the need for a dividend of at least £787,000. He referred to an earlier transaction he had been involved in where, in order to distribute shares in a subsidiary company it had been first necessary to revalue the subsidiary. On that basis he advised that Vital would need to be revalued before the dividend "…and we can't do the dividend until that is done". He pointed out that the directors would need to decide on the appropriate value.

67. On 23 August 2007, Ms Brewer emailed Mr Joyce to ask what the consequence would be if a dividend in specie was made, and it later turned out that the valuation of Vital was incorrect. Mr Joyce's response on 23 August 2007 was to say that there would then be a risk that the distribution was not lawful. "There has to be adequate distributable profits in Holdings. There are not presently adequate profits but these can be created by a revaluation and that revaluation is distributable for this purpose so that is all fine if everything is done at market value."

68. In fact, as was pointed out by David Richards LJ in the Court of Appeal at an earlier stage in these proceedings ([2017] EWCA Civ 557, at [26]), the revaluation was probably unnecessary, and that all that was required was that there were sufficient distributable reserves to distribute the shares in Vital at their historic cost (£750,000), although the matter was not expressly put beyond doubt until the Companies Act 2006, s.845.

69. As I have noted above, Tenon Audit was clearly aware of the planned Demerger Transaction, being copied into at least some of the emails passing between Mr Beckett, Mr Joyce and Tenon CF. I also infer that it is likely there were communications between individuals within Tenon Audit and Tenon CF beyond the few that are disclosed by the relatively limited disclosure provided by Tenon.

70. The disclosure provided by Tenon Audit reveals a close working relationship with Mr Beckett and Mr Martin, with numerous meetings and other communications on a regular basis during 2006 and 2007. Internal documents provided by Tenon Audit include those relating to its consideration of "going concern" in relation to BHUK for the purposes of its audit of the financial statements for the year ending June 2006 and

the year ending 30 June 2007. These show that Tenon was provided with detailed forecasts for each of the companies in the Group, that it gave consideration to the need for impairment of inter-company receivables and to goodwill in its subsidiaries. In relation to the latter, as I explain in more detail below, Tenon Audit identified in August 2006 a need for an impairment review in respect of the goodwill of various subsidiaries, including K2 Con, K2 Glass and Cestrum, which was duly carried out in February 2007. As a result of that review – which compared the carrying value of each subsidiary with its recoverable amount – it was concluded that no impairment was required.

71. Tenon Audit was engaged in preparing and auditing the financial statements for all companies in the Group for the year ended 30 June 2007 at the same time as the preparations were continuing for the Distribution. In addition to the notes of the pre year end meeting on 18 May 2007, the recent Tenon Audit disclosure includes copies of numerous documents evidencing its work on the accounts, including the "statutory accounts packages" for certain of the companies dated 1 August 2007, a schedule of Investments of BHUK dated 13 August 2007 and an "intangible assets lead schedule" for K2 Con dated 22 August 2007. There is also a note of an update meeting, between Mr Beckett and Mr Martin on behalf of the Group and Mr Moss, Mr Duffy and Ms Sutcliffe of Tenon Audit on 24 August 2007 (the note having been updated on or shortly before 10 October 2007). This indicated that Tenon Audit were to prepare the statutory accounts, and drafts would be available by 12 October 2007. An email of 10 October 2007 from Mr Duffy to Mr Beckett enclosed a copy of the note of the meeting on 24 August with annotations in red showing where matters had progressed since the meeting.

72. Tenon Audit gave clean audit opinions in respect of the accounts of BHUK and its core trading subsidiaries, prepared on a going concern basis, in January 2007 (in respect of the 2006 accounts) and in February 2008 (in respect of the 2007 accounts). There was some debate between the parties as to the precise consequences of a clean audit opinion in respect of accounts prepared on a going concern basis. I agree with the claimants that it is not to be equated with a determination by the auditors that the company was solvent. It does, however, indicate that the auditors concluded there were reasonable grounds for believing that the company would continue in operational existence for at least the next twelve months without entering a formal insolvency process.

73. A board meeting of BHUK was held on 29 August 2007, at which a decision was reached to commence the demerger process. The meeting was attended by all of the directors. Mr Beckett produced a first draft of the minutes. These recorded the following:

    i) The purpose of the meeting was to consider the potential demerger, sale and appropriate valuation of Vital;

    ii) The board reviewed financial projections of the Group (the projections are not in evidence), noting that without significant financial investment the Group would be in a significantly negative cash position by the end of December with a deficit of £1.6 million by the end of January 2008;

iii) Three possible sources of funding were considered: the sale of the building owned by Cestrum (which Knight Frank were proposing to market for sale at between £2.2 million and £2.4 million); recovery of costs from the Ultraframe litigation; and the demerger of Vital, the disposal of 30% of its shares with a £3 million initial consideration being injected into the Group;

iv) Mr Fielding reported that the Group had received an offer from SSE to acquire 30% of Vital for £6m (which he considered to be excessive), and Mr Beckett reported that in March 2007 Tenon had valued Vital at £6.4 million. Mr Fielding proposed that Vital be valued for the purposes of the Demerger Transaction at £10.48m (being an amalgamation of the valuation implied by the SSE offer and the earlier Tenon valuation);

v) Mr Kavanagh sought clarification on directors' duties so far as factors that should be considered and steps that should be taken in the process of agreeing to the demerger. Mr Beckett said that he was unsure and that he would contact Mr Joyce of Addleshaw Goddard in this regard;

vi) The minute concluded: "subject to [Mr Joyce's] confirmation that appropriate steps had been taken and appropriate factors had been taken into account it was proposed and agreed unanimously that the investment in Vital Energi be revalued at £10.48 million in Burnden Holdings and that the demerger process be commenced."

74. Mr Beckett emailed these draft minutes to Mr Joyce on 30 August 2007, pointing out that he had been asked to seek clarification from Mr Joyce including as to the matters the directors should take into account (as indicated in the draft minutes). Mr Joyce responded later that day, commenting that the minute was fine for the company's own internal purposes, but attaching a revised minute which he said could be provided to SSE, unless the directors did not want SSE to know about the earlier Tenon valuation of Vital. He had made substantial changes to the minute. In part this involved re-ordering the contents of the minute, but it also involved removing parts, including for example the whole section dealing with the Group's financial position (which I infer from the covering email was something Mr Joyce considered it would be inappropriate to provide to SSE). Mr Joyce also added other sections, for example expanding the section headed "purpose of the meeting" to provide a more detailed explanation of the proposed Demerger Transaction.

75. The claimants place particular reliance on a sentence appearing in Mr Beckett's original note which referred to a possible further valuation by Tenon, for a fee of approximately £15,000 and continued: "it was agreed the company could not afford to pay Tenons a fee for an exercise that was likely to give a range of views between the original valuation and £20m". The claimants contend that this demonstrates that the directors knew BHUK was insolvent, since it could not even afford to pay £15,000 for a further valuation. Mr Beckett's evidence was that, while inelegantly drafted, what he meant was there was no point in paying Tenon for something which would be of no value: "I didn't feel that was value for money". Mr Joyce's evidence was that was how he understood the sentence at the time. He in fact re-drafted it to accord with that understanding. I accept this evidence. It was obviously not the case that BHUK was unable to find £15,000 to pay Tenon for a further valuation.

76. The circumstances in which these minutes came to be re-drafted was the subject of trenchant criticism by the claimants. Particular complaint is made of the change in relation to the last paragraph (see paragraph 73(vi) above), so that it read as follows: "The proposed reorganisation was approved and Stephen Beckett was instructed to liaise with Tenon and Addleshaw Goddard to put this into effect, including at all relevant stages appropriate advice to the Board that its actions were proper in the context of the interest of the Group, its shareholders (including those with unexercised options) and its creditors." Importantly, the conditionality of the approval as expressed in Mr Beckett's note ("subject to John's confirmation that appropriate steps had been taken and appropriate factors had been taken into account…") was removed.

77. Mr Joyce provided two witness statements and attended trial to be cross-examined. His evidence is that the directors relied on him throughout to ensure that the transaction was carried out correctly. He said that his working relationship with the Group was such that if there was any issue with the transaction the directors would have expected him to have told them. He said that, while he could not remember if this actually happened, he is sure that at some point Mr Beckett would specifically have sought reassurance from him that "they were ok". He said that he had a history of working with Mr Beckett and that Mr Beckett would commonly seek such reassurances from him. While Mr Joyce cannot recall giving any formal advice that the directors were acting lawfully in causing BHUK to enter into the transaction (and there was certainly no written advice to that effect), he is certain that the directors understood from his ongoing involvement in the transaction – for example in drafting the board minute for the meeting on 12 October 2007 when the distribution in specie was approved – that he was satisfied as to the legality of the transaction. As Mr Joyce pointed out, this was not merely a case of standing by and allowing the directors to act. Rather, he was intimately involved in effecting the transaction with them. He emphasised that he did not (and does not) believe there were any issues with the Demerger Transaction.

78. No allegation of impropriety is made against Mr Joyce. He is implicitly criticised, however, in relation to the minutes of the meeting on 29 August 2007. Mr Joyce said that to the extent that he made additions to the minutes, he was referring to matters which he assumed had taken place. He said that if he had inserted matters that had not been discussed, then he would have expected Mr Beckett to come back to him and correct it. He said that "…nothing about the way I have changed these minutes is different to the way I would have approached board meetings for any other corporate client in similar or any other circumstances." He also said that he had no discussions with Mr Fielding at any stage about his changes to the minutes of this meeting.

79. I accept Mr Joyce's evidence. He was straightforward in his answers, which were consistent with the contemporaneous documents. He did not shy away from taking responsibility for having advised on the transaction, in the face of trenchant criticism of it from the claimants. Whether or not his conduct in revising the minute without prior positive instructions is open to criticism is beside the point. I accept his evidence that he did this in accordance with his usual practice, such that there was nothing nefarious about it but, more importantly, neither Mr nor Mrs Fielding played any part in it.

80. In the meantime, Mr Beckett had been liaising with both Mr Joyce and Tenon as to the proposed dividend from K2 Glass, which had previously been identified as

necessary in order to ensure that BHUK had adequate distributable reserves to effect the Distribution. The dividend (of £300,000) would be used to reduce £300,000 of the inter-company debt due from BHUK to K2 Glass.

81. On 4 September 2007 Mr Beckett asked Ms Brewer for the revaluation number to put through BHUK's accounts in August. Ms Brewer forwarded that request to Mr Duffy and Mr Moss of Tenon Audit saying that Mr Beckett had revalued Vital at £10.48 million and asking for confirmation as to the carrying value. Mr Duffy responded that the carrying value of Vital was £750,000. He said he had discussed the proposed revaluation with Mr Moss and questioned why it was being done, and on what basis the value had been set at £10.48 million. Ms Brewer passed that information on to Mr Beckett (copying in Mr Moss).

82. On 13 September 2007 Mr Joyce sent Mr Beckett and Mr Fielding a series of charts showing the group structure at each successive stage of the proposed Demerger Transaction.

83. On 21 September 2007 Mr Beckett emailed Mr Joyce (copying in Ms Brewer, as well as Mr Fielding) referring to the dividend he had caused K2 Glass to make, and asking: "Do we need to agree a dividend in specie from BHUK to BHU Holdings Limited? Can I have a board minute please?" Mr Joyce responded the same day, saying "I will do the minutes for the dividend in specie but we can't do that until after the share for share exchange which follows the exercise of the EBT options [referring to the employee incentive share options]. The dividends you have done all need to be evident from the accounts to be produced to the meeting at which the dividend in specie will be declared, which is why yours had to be done and recorded first."

84. Mr Joyce sent Mr Beckett (copying Mr Fielding) draft minutes for a meeting declaring the Distribution on 1 October 2007, saying: "Once the new holding company is in place, we will be ready to declare the dividend in specie. I attach the minutes and resolution for your consideration. You need to let me have the management accounts showing the revalued Vital, plus the date of the last board meeting at which the revaluation was agreed." The enclosed draft minutes recorded as present Mr and Mrs Fielding and Mr Beckett. Having recited that the meeting's attention was drawn to a recent dividend paid to BHUK by K2 Glass, the revaluation of Vital and the fact that s.276 of the 1985 Act entitled the company to treat the revaluation of Vital as a realised/distributable profit, the draft minutes stated: "the consequence of the above being that the Company had distributable reserves of an amount greater than the present market value of the entire issued share capital of Vital…"

85. Mr Beckett appears at this stage not to have understood the statement that the distributable reserves were greater than the present market value of the shares in Vital, considering that it ought to refer to the original value of the shares, being £750,000, querying this in an email of 4 October 2007 to Mr Joyce. Mr Joyce's response is not in evidence, but Mr Beckett must have had matters satisfactorily explained to him, given the terms of his email of 8 October 2007 enclosing the Interim Accounts, referred to in the next paragraph. Mr Beckett also wrote: "Eamon Kavanagh should be at the meeting as well."

86. On 8 October 2007 Mr Beckett faxed to Mr Joyce the management accounts for BHUK for August 2007, showing the revaluation of Vital and the dividend of £300,000 from K2 Glass. These were intended to be the relevant interim accounts for the purposes of the Distribution (the "Interim Accounts"). On 9 October 2007 Mr Beckett emailed Mr Joyce to enquire as to the timetable for the dividend in specie. Mr Joyce replied saying that the dividend in specie was ready to do now.

87. In the afternoon of 12 October 2007 (apparently after the meeting had taken place) Mr Joyce emailed to Mr Beckett the revised minutes for the meeting of BHUK's directors in relation to the dividend in specie. These identified Mr and Mrs Fielding and Mr Whitelock as present, with apologies being received from Mr Beckett and Mr Kavanagh. It was a copy of this version of the minutes that Mr Fielding signed, with the time and date (11:40 am on 12 October 2007) added. The operative resolution passed at the meeting was to recommend the Distribution.

88. The Distribution was in fact effected by a written special resolution of BHUK dated 12 October 2007, signed by Mr Fielding. He was authorised to sign this resolution by a meeting of the sole shareholder, BHUH, also dated 12 October 2007, which meeting resolved that the dividend in specie of the entire issued share capital of Vital should be paid and that Mr Fielding be authorised to sign the special resolution.

89. On the basis of the matters described in the above paragraphs, I make the following findings of fact relevant to various of the causes of action advanced in this case.

90. First, the responsibility for preparing the Interim Accounts was (as between the directors of BHUK) that of Mr Beckett. Mr and Mrs Fielding, in particular, relied on Mr Beckett in this regard, in the knowledge that he was liaising with Tenon and Addleshaw Goddard as described in the following paragraphs.

91. Second, the entries in respect of assets and liabilities in the Interim Accounts were those appearing in the accounts software package which underlay the management accounts and the statutory accounts more generally. While Mr Beckett did not seek assistance from Tenon Audit specifically in drawing up the Interim Accounts, he liaised closely with, and relied upon, Tenon Audit in relation to the accuracy of the entries for the relevant assets and liabilities in the statutory accounts, which were being prepared (for the year ended 30 June 2007) in parallel with the preparation for the Distribution.

92. Third, Mr Beckett liaised closely with Tenon CF so far as the identification – and creation – of sufficient distributable reserves to enable the Distribution to take place were concerned.

93. Fourth, I find (contrary to submissions made by the claimants) that there is nothing wrongful or suspicious in the "creation" of profits for this purpose. Where, as here, the relevant company is a holding company with no trade of its own, then provided that there are sufficient distributable reserves in one or more of its subsidiary companies, it is open to it to create profits by procuring a dividend to it from those subsidiaries.

94. Fifth, Mr Beckett, and the directors of BHUK, relied on Mr Joyce so far as the legal requirements of the Distribution were concerned.

95. Sixth, the financial circumstances of the Group were fully disclosed to Tenon CF, Tenon Audit and Mr Joyce, there being no attempt to hide from any of them the financial difficulties facing the Group.

## E3. The statutory requirements relating to distributions

96. BHUK's articles permitted a dividend to be declared by ordinary resolution in an amount not more than that recommended by the directors of the company.

97. S.263 of the 1985 Act provides that a company shall not make a distribution except out of profits available for the purpose.

98. "Profits available for distribution" are a company's "accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made": s.263(3) of the 1985 Act.

99. "Realised profits" and "realised losses" mean "such profits or losses of the company as fall to be treated as realised in accordance with principles generally accepted, at the time when the accounts are prepared, with respect to the determination for accounting purposes of realised profits or losses": ss.262(3) and 742(2) of the 1985 Act.

100. By s.270(2) of the 1985 Act, the amount of a distribution which may be made is determined by reference to the following items as stated in the company's accounts:

> "(a) profits, losses, assets and liabilities,
>
> (b) (i) In the case of Companies Act individual accounts, provisions of any of the kinds mentioned in paragraphs 88 and 89 of Schedule 4 (depreciations, diminutions in value of assets, retentions to meet liabilities etc), and (ii) in the case of IAS individual accounts, provisions of any kind, and
>
> (c) share capital and reserves (including undistributable reserves)"

101. Paragraph 88 of Schedule 4 to the 1985 Act states that "References to provisions for depreciation or diminution in value of assets are to any amount written off by way of providing for depreciation or diminution in value of assets". Paragraph 89 of Schedule 4 states that "References to provisions for liabilities or charges are to any amount retained as reasonably necessary for the purpose of providing for any liability or loss which is either likely to be incurred, or certain to be incurred but uncertain as to amount or as to the date on which it will arise."

102. The existence of sufficient distributable profits is to be judged, in the first place, by reference to the most recent set of annual accounts: s.270(3) of the 1985 Act. Where, however, the distribution would be found to contravene the relevant section if reference were made only to the company's last annual accounts", interim accounts may be relied upon: s.270(4). Interim accounts mean "those necessary for a reasonable judgment to be made as to the amounts of the items mentioned in [s.270(2)]": see s.270(4).

## E4. Is the liability of directors strict or fault based?

103. The claimants contend that the liability of directors involved in the making of an unlawful distribution is strict. The defendants contend that it is a fault-based liability. This is an issue which was raised in, but left open by, the Supreme Court in *Revenue and Customs Comrs v Holland; in re Paycheck Services 3 Ltd* [2010] 1 WLR 2793 ("*Paycheck*"). In that case, the principal issue was whether the defendant, who was a director of a corporate shareholder of the company, was acting as a de facto director of the company, such that he could be made liable for payment of unlawful dividends. The Supreme Court held that he was not. The question whether a director's liability in such circumstances was strict or fault based therefore did not arise. Lord Hope JSC nevertheless offered some brief comments (at [45] – [48]).

104. He noted two competing lines of authority:

i) cases in which it has been said without qualification that directors are under a duty not to cause an unlawful and ultra vires payment of a dividend (citing *Re Exchange Banking Co (Flitcroft's Case)* (1882) 21 Ch D 519; *In re Lands Allotment Co* [1894] 1 Ch 616, 638; *Selangor United Rubber Estates Ltd v Cradock (No.3)* [1968] 1 WLR 1555, 1575; *Belmont Finance Corpn v Williams Furniture Ltd (No.2)* [1980] 1 All ER 393,404 and *Re Loquitur Ltd* [2003] 2 BCLC 442, 471-472);

ii) a line of authority to the effect that a director is only liable if he knew or ought reasonably to have known that it was a misapplication (citing *Re County Marine Insurance Co* (R*ance's Case)* (1870) LR 6 Ch App 104, 118; Re *Kingston Cotton Mill Co (No.2)* [1896] 1 Ch 331, 345-348; *Dovey v Cory* [1901] AC 477, 489-490 and Re *City Equitable Fire Insurance Co* Ltd [1925] Ch 407, 426, per Romer J).

105. He commented that "the trend of modern authority supports the view that a director who causes a misapplication of a company's assets is in principle strictly liable to make good the application, subject to his right to make good, if he can, a claim to relief under section 727 of the Companies Act 1985". He considered that the authorities in favour of the contrary view came to an end with *Dovey v Cory*, and added:

> "Furthermore, the whole point of introducing the right to claim relief under section 727 was to enable the court to mitigate the potentially harsh effect of being held strictly liable. That relief was introduced by section 32 of the Companies Act 1907, so it was not available when most of the cases in this line of authority were being decided."

106. While he found it unnecessary to express a definite view, noting that the point had not been fully developed in oral argument and that it was academic in that case since it was accepted that the defendant would have been entitled to relief under s. 727 of the 1985 Act had he acted reasonably, he nevertheless expressed the "better view" to be that where it is accepted that the dividends were unlawful a director who causes their payment is strictly liable, subject to his right to claim relief under the statute."

107. While the point was dealt with somewhat cursorily in the course of the trial, I have received detailed post-trial written submissions from the parties addressing the competing lines of authorities. In order to resolve the apparent conflict, it is necessary to delve into those authorities in some detail.

***The 19th Century authorities***

108. The earliest of the cases cited by Lord Hope is *Re County Marine Insurance Company, Rance's Case* (1870) L.R. 6 Ch 104. The directors caused a dividend to be paid, without preparation of a profit and loss account of the company. Lord Romilly MR at first instance held that there had in fact been insufficient distributable profits, but that the directors had acted in good faith, so that no claim lay against them. He formulated the principle to be applied (which he described as very clearly established by all the cases) as: "When an improper payment has been made, if it be a mere error of judgment, it cannot be recovered; if it be a fraudulent payment, then it can". He appears to have been using the concept of a "fraudulent" payment in a broad sense, giving as an example a director who had been presented with books of the company which showed that the company was not in a position to pay a bonus, but who refused to examine the books. He went on:

> "But if before declaring the bonus he reads the report, examines the books, and finds good reason for what appears there, or from the advice of some competent person whom he has consulted, is induced to trust the accuracy of the statement made in the report, then he is, in my opinion, absolved from liability for the payment. If the report be made by a competent person free from all suspicion, he is not, in my opinion, bound to examine into the accuracy of the report itself; but if the report be made by a competent person, duly employed for the purpose, even if it be erroneous, if the director is deceived by it, if he acts upon it believing it to be true, however improper the payment may be, still he is not liable as in the case of a fraudulent payment; nor is he, although he, in common with the other shareholders, participates in the benefits to be derived from the declaration of the bonus. Therefore, in such cases, he would not be liable to refund. Any other doctrine would, as it appears to me, be quite alien to the spirit of the Act of Parliament in question, and also quite opposed to the doctrines of equity as administered by this Court. In order to make directors liable in a case like this there must be either proof of distinct fraud or else of such gross and wilful negligence as is equivalent to fraud."

109. The Court of Appeal reversed the decision on the facts, finding that there had been a "gross neglect" by the directors in declaring the bonus, because they had failed to comply with the basic requirement of preparing an account to determine whether the dividend could be paid. The Court of Appeal distinguished between: (1) directors who declared a dividend without any profit or loss account having been made out; and (2) directors who complied with the requirement to prepare accounts demonstrating sufficient profits, including where they relied on others to prepare them, and it turned out that the accounts were wrong. In the former case, it was for the directors to

establish that the dividend was lawfully paid out of profits. In the latter case, it was necessary to find bad faith on the part of the directors in order to render them liable to repay the dividend.

110. James LJ said this (at pp.117-118):

> "The directors simply had before them the cash balance of the receipts and payments, and, without making the slightest provision in that account for anything whatever, they proceed out of that balance to declare this bonus. I quite agree that it would have been different if there had been, as there ought to have been in the ordinary course of business, a balance-sheet *bonâ fide* made out with proper assistance, so as to ascertain the true state of the company … If the directors, by placing unfounded reliance upon the representations of their servants or actuaries, had arrived at the conclusion that they had made a divisible profit, this Court ought not, I say, to sit as a Court of Appeal from that conclusion, although it might afterwards be satisfactorily proved that there were very great errors in the accounts which would not have occurred if they had been made out with greater strictness or with more scrutinising care" (see also Mellish LJ, at pp.122-123).

111. In *Re National Funds Assurance Company* (1878) 10 Ch D 118, the articles empowered the directors to pay interest on paid up capital at the rate of 5% per annum. The company never made any profits, yet the directors regularly paid interest to the shareholders (with the consent of the general body of shareholders) out of capital. The company went into liquidation and the liquidator brought a claim under s.165 of the Companies Act 1862 (which provided for an examination into the conduct of a director who was guilty of a misfeasance or breach of trust, and for an order compelling the director to repay misapplied monies). Jessel MR held that this was a clear misapplication of the company's funds and a breach of trust by the directors. Each director was ordered to pay the amounts that he participated in paying, on a joint and several basis. The directors contended that they acted in good faith, so ought not to be made liable. Jessel MR rejected that argument, not on the basis that liability was strict, per se, but on the basis that since the directors were aware of all the facts which rendered the dividend an unlawful return of capital, they could not claim to be in good faith. At p.128, he said this:

> "As to saying they did it bona fide, I think it is impossible to come to that conclusion; a man may not intend to commit a fraud, or may not intend to do anything which casuists might call immoral, and he may be told that to misapply money is the right thing to do, but when he has the facts before him— when the plain and patent facts are brought to his knowledge—as I have often said, and I say now again, I will not dive into the recesses of his mind to say whether he believed, when he was doing a dishonest act, that he was doing an honest one. I cannot allow that man to come forward and say, "I did not know I was doing wrong when I put my hand into my neighbour's pocket and took so much money out and put it into my own." It is

> impossible in a Court of Justice to call a particular act a bona fide act simply because a man says that he did not intend to commit a fraud. This Court is not, as I have often said, a Court of conscience, but a Court of Law; and when a man misappropriates money with a knowledge of all the facts, I cannot allow him to say that he is not liable simply because somebody or other told him that he was not doing wrong, or that somehow or other he convinced himself that he was not doing wrong."

112. *Re Exchange Banking Company (Flitcroft's Case)* (1882) 21 Ch D 519 is the first case in the line of authority cited by Lord Hope in support of the proposition that directors' liability is strict. At p.532, Jessel MR set out the facts as follows: "The directors had for several years been in the habit of laying before the meetings of shareholders reports and balance sheets which were substantially untrue, inasmuch as they included among the assets as good debts a number of debts which they knew to be bad. They thus made it appear that the business had produced profits when in fact it had produced none". Bacon VC, at first instance, held that the case was identical with *National Funds Assurance Company*, concluding (at p.526): "it being admitted that the directors here did misapply moneys of the company, it follows that they have exposed themselves to the consequences of the 165th section [of the Companies Act 1862]".

113. On appeal, the appellants contended that although directors are trustees for the company, they are trustees for no-one else and that the company had debarred itself from complaining. The Court of Appeal rejected this, holding that the shareholders, even if they knew all the facts, could not effectively sanction a return of capital effected otherwise than in accordance with the statute. Jessel MR agreed that the case was covered by his earlier decision in *National Funds Assurance Company*. One reason why shareholders could not sanction an unlawful return of capital was that creditors relied on the faith of the representation by the company that the capital shall be applied only in the business. At p.534 he concluded: "It follows then that if directors who are *quasi* trustees for the company improperly pay away the assets to the shareholders, they are liable to repay them." Brett LJ agreed that directors who paid away part of the capital of the company for purposes not authorised by the memorandum or articles were guilty of a breach of trust.

114. It was not in dispute that the directors knew that the debts were bad. There was accordingly no argument addressing the question whether their liability was strict or fault based, and no discussion of that issue in the judgments. It is highly unlikely, however, given the express approval of Jessel MR's judgment in *National Funds Assurance Company*, that either Bacon VC or the Court of Appeal considered that liability was strict, in the sense that a director who was (without fault) not aware of the facts which rendered the dividend unlawful would nevertheless be liable.

115. *Flitcroft's Case* and *National Funds Assurance Company* were both referred to in *Re Oxford Benefit Building and Investment Society* (1886) 35 Ch D 502. Kay J, at p.512, adopted the language of Jessel MR, set out above, from the *National Funds Assurance* case. The directors had declared dividends without distinguishing between realised and estimated profits, and by relying on the book value of a property which they had revalued at a much lower figure. This constituted bad faith, or carelessness

amounting to bad faith, sufficient to make them jointly and severally liable to repay the dividends.

116. The next case is *Leeds Estate &c Co v Shepherd* (1887) 36 Ch D 787. The company never made any profits, except in one year, but the directors declared and paid dividends in each year from the commencement of business. Although balance sheets, on the basis of which the dividends were paid, were prepared by a manager, and certified by auditors, no proper statement of income and expenditure or auditor's report was ever laid before the company. On the facts, Sterling J concluded that the directors had fallen short of the standard of care which they ought to have applied to the affairs of the company.

117. The directors were also accused of having made certain advances to borrowers in breach of duty.

118. Stirling J noted that it had "now been decided" that directors are trustees or *quasi* trustees of the capital of the company, and are liable as trustees for any breach of duty as regards the application of it, but "when such liability is sought to be enforced it has to be determined on the facts of each particular case whether a breach of duty has been committed."

119. He then contrasted actions which were within the powers of the company (such as the advances complained of) and those which were beyond the powers of the company. As to the former, the directors were not to be made liable for loss occasioned by mere imprudence or error of judgment in the exercise of the powers conferred on them. The position of directors, in relation to such actions, was wholly different from trustees of a settlement. That is because funds of a trading company are placed under the control of directors "in order that they might be employed for the acquisition of gain, and risk (greater or less, according to circumstances) is of the very essence of such employment", whereas funds entrusted to the trustee of a settlement are intended to be preserved for the benefit of those successively entitled to them (see p.798). On this ground, the claims in respect of the advances were dismissed.

120. The payment of dividends out of capital (which was beyond the powers of the company), however, "stands in a very different position". Stirling J said that it followed from *National Funds Assurance Company* and *Flitcroft's Case* that "…that directors who make such payments either with actual knowledge that the capital of the company is being misappropriated or with knowledge of the facts which establish the misappropriation are liable as for a breach of trust."

121. He noted that Lord Romilly in *Rance's Case* had appeared to suggest that it was necessary to establish either fraud or "such gross and wilful negligence as is equivalent to fraud". He considered, however, that the Court of Appeal in *Rance's Case* had approved a lower standard, saying (at p.801):

> "It seems to me that the views expressed by the learned Judges who decided *Rance's Case* are consistent with the proposition that directors who are proved to have in fact paid a dividend out of capital fail to excuse themselves if they have not taken reasonable care to secure the preparation of estimates and statements of account such as it was their duty to prepare and

> submit to the shareholders, and have declared the dividends complained of without having exercised thereon their judgment as mercantile men on the estimates and statements of account submitted to them."

122. This, he said, was consistent with the conclusion of Kay J in the *Oxford Benefit* case (above) in which Kay J had held that "directors who had omitted to lay before the shareholders proper accounts of income and expenditure and balance sheets, and who acted negligently or carelessly as regards the ascertaining of the profits which they profess to divide, were jointly and severally liable to repay the sums improperly paid out of capital by way of dividends."

123. *Re Sharpe* [1892] 1 Ch 155 is another in the line of cases identified by Lord Hope as indicating strict liability. The articles provided that interest on money paid up on shares should be paid until otherwise determined by the directors. They also provided that no dividend or bonus should be paid out of profits. The company never made any profits. At first instance, North J held that the payments were made "under circumstances under which no one could for a moment believe that they were made out of profits. The fact that the receipts of the company did not equal the expenditure was itself conclusive upon that point. Moreover, none of the steps were taken which have been considered in some cases to justify directors in making a payment in respect of dividend in the bona fide belief that there were profits, when in point of fact there were none." He referred to *Rance's Case* for the proposition that directors cannot rely on accounts made out for them by competent experts, "when, in point of fact, the accounts which are essential for the purpose of ascertaining whether there is a profit or not have never been made out at all." It was submitted to him that the directors acted honestly, as to which he said: "I do not wish to suggest the contrary for a moment; but I do say this, that he and the other directors who were acting with him certainly did not do their duty to the shareholders in not having the proper accounts made out before any such payment was thought of for a moment."

124. The Court of Appeal upheld North J's conclusion that the payment of interest out of capital when there were no profits was ultra vires, notwithstanding the clause in the articles. Lindley LJ put it as follows: "As soon as the conclusion is arrived at that the company's money has been applied by the directors for purposes which the company cannot sanction, it follows that the directors are liable to replace the money, however honestly they may have acted." The argument to the contrary had been based upon *Pickering v Stephenson* (1872) LR 14 Eq 322, a case which Lindley LJ pointed out had been overruled by the Court of Appeal in *Cullerne v London and Suburban General Permanent Building Society* (1895) 25 QBD 485. Both cases involved directors who caused the company to enter into an unlawful transaction because they mistakenly believed the transaction to be lawful (i.e. they made a mistake as to the legal consequences of their actions). In *Cullerne* Lindley LJ said, at p.490: "if a director acting ultra vires, i.e., not only beyond his own power, but also beyond any power the company can confer upon him, parts with money of the company, I fail to see on what principle the fact that he acted bona fide and with the approval of a majority of the shareholders can avail him as a defence to an action by the company to compel him to replace the money."

125. It is important to note that none of *Sharpe*, *Pickering* or *Cullerne* raised the question of a director's liability for an ultra vires transaction where the director (without

negligence) was unaware of the facts giving rise to the legal conclusion that the transaction was unlawful. *Rance's Case*, which was such a case, was cited with approval by North J, and no adverse comment was made about it in the Court of Appeal.

126. *Re Lands Allotment Company* [1894] 1 Ch 616 is a further case in the line cited by Lord Hope as indicating strict liability. The company had no power to invest its capital in the shares of other companies. The directors caused it to do so, in discharge of a debt. The case is often cited for the proposition that, while directors are not trustees, they are treated as having committed a breach of trust if they deal with the funds of the company: see, for example, per Kay LJ at p.638:

> "Now, case after case has decided that directors of trading companies are not for all purposes trustees or in the position of trustees, or quasi trustees, or to be treated as trustees in every sense; but if they deal with the funds of a company, although those funds are not absolutely vested in them, but funds which are under their control, and deal with those funds in a manner which is beyond their powers, then as to that dealing they are treated as having committed a breach of trust."

127. The question whether liability was strict or fault-based was not discussed. In fact, there was no doubt that the defendant directors were aware of the transaction and, upon the assumption that it was an ultra vires transaction, it was conceded that the transaction was improper and all those directors who were parties to it were liable to make good the money: see per Lindley LJ at p.631. So far as the defendant Brock was concerned, the issue was whether he was sufficiently mixed up in the transaction to render him liable. In that context, Lindley LJ said (at p.636), "He not only approved of it, but he thought it was an uncommonly good thing for the shareholders, and he claims credit to himself for his intelligence in seeing, as he thought, that it was an uncommonly good thing. I take him as doing exactly what he says he did – exercising his judgment upon it, believing perfectly honestly it was intra vires, but making a mistake as to the powers of the directors in investing money." Accordingly, this was another case where the director knew all of the facts which rendered the transaction unlawful but made a mistake as to the legal consequences of those facts.

128. The question whether liability was strict or fault based was raised squarely in *Kingston Cotton Mill Company (No.2)* [1896] 12 Ch 331. The company had, for some years prior to its winding-up, published balance sheets, signed by its auditors, in which (1) the value of the company's mill and machinery and (2) the value of its stock-in-trade were overstated. The directors and one of the two auditors knew that (1) was an overvalue, but as to (2) they relied on certificates provided, deliberately and falsely, by one of the directors, J. Dividends were for some years paid on the footing that the balance sheets were correct. If the value of (1) or (2) (or both) had been deducted, there would have been insufficient profits. Vaughan Williams J held that the directors (other than J) were not liable.

129. Vaughan Williams J first dealt with the issue as one of principle saying (at pp.345-356) that if he were free to decide the case according to his own judgment he would hold "…that a director is in no sense a trustee. The Act does not say that a director is

a trustee. He is not the owner of the funds which he has to apply; and I should have thought that he might safely be treated as the paid manager and agent of the company, and might well be held not to be responsible for the misapplication of the funds of the company unless he, through want of care or fraud, misapplied those funds." He considered that James and Mellish LJJ, in the passages from their judgments in *Rance's Case* which I have set out above, supported his view.

130. He noted, however (at p.348), that there was a "considerable bulk of authority to shew that directors are trustees for the company of such funds as are committed to their control in such sense that they will be liable for a misapplication of the funds which is ultra vires the company, independently of any proof of fraud or actionable negligence by the directors", citing *National Funds Assurance Co, Flitcroft's Case*, the *Oxford Benefit* case, *Re Leeds Estate Building and Investment Co v Shepherd* and *Re Faure Electric Accumulator* [1888] 40 Ch D 141.

131. He concluded, however, as follows (at pp.346-347):

> "but in no one of those cases can I find that directors were held liable unless the payments were made either with actual knowledge that the funds of the company were being misappropriated or with knowledge of the facts that established the misappropriation … On the whole I have come to the conclusion that there is no such bulk of authority as binds me to hold that directors who pay away the funds of the company under the honest and reasonable belief in a state of facts which would justify the payments must be held liable to replace those funds because it turns out that on the true facts the payments were ultra vires."

132. The case went to the Court of Appeal ([1896] 2 Ch 279), but on different aspects and these conclusions of Vaughan Williams J were not disturbed.

133. *Dovey v Cory* [1901] AC 477 is a case in the line identified by Lord Hope as indicating fault-based liability. The defendant director, Mr Cory, caused the company to pay a dividend out of capital because bad and irrecoverable debts were included amongst the assets of the company whereas, if they were written off as they ought to have been, the balance sheet would not have shown any profits available for distribution. At first instance, Wright J had ordered Mr Cory to repay the dividend. That decision was reversed by the Court of Appeal. The House of Lords affirmed the Court of Appeal's decision, finding that as Mr Cory had been entitled to rely on others, including the general manager and the company's auditors, for the accuracy of the accounts, and was not himself negligent or reckless in relation to the payment of the dividend out of capital, he was not to be made liable for its repayment.

134. Lord Halsbury LC concluded (at p.485) that the answer was to be found in the fact that Mr Cory was not himself conscious that the payment of the dividend was out of capital and unless he could be made responsible for not knowing it, the charge was not made out. At p.486 he said:

> "I cannot think that it can be expected of a director that he should be watching either the inferior officers of the bank or verifying the calculations of the auditors himself. The business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to details of management … The provision made for bad debts, it is well said, was inadequate; but those who assured him that it was adequate were the very persons who were to attend to that part of the business…"

135. Lord Davy reached the same conclusion in reliance on three earlier decisions (*Re Mercantile Trading Company, Stringer's Case* (1869) L.R. 4 Ch 475, *Rance's Case* and *Leeds Estate Building and Investment Co v Shepherd*). I have considered the second and third of these above. In the first of them a dividend had been paid on the basis of an estimate as to the value of the company's assets. The Court of Appeal held that the directors having estimated the value in good faith, they could not be made liable to replace the dividend when the assets were totally lost and the company wound up. That was, however, because, an honest estimate having been made, the dividend must be considered to have been made out of profits. No question of personal liability therefore arose. The case is therefore of limited assistance.

136. Lord Davy expressed agreement with the statement of the law by Stirling J in *Leeds Estate Building* case, quoted at paragraph 121 above. He also expressed agreement with Lord Romilly's judgment in *Rance's Case*, albeit he interpreted Lord Romilly as contemplating (in referring to a director "wilfully shutting his eyes") that a director would be liable if he was guilty in performing his duties of "culpable negligence or reckless indifference". At p.492, Lord Davey said this:

> "I think the respondent was bound to give his attention to and exercise his judgment as a man of business on the matters which were brought before the board at the meetings which he attended, and it is not proved that he did not do so. But I think he was entitled to rely upon the judgment, information, and advice of the chairman and general manager, as to whose integrity, skill, and competence he had no reason for suspicion."

137. The claimants refer to the fact that the articles of the company, in *Dovey v Cory*, contained an indemnity, save for wilful act or default (see the report of the decision of the Court of Appeal in that case, at [1899] 2 Ch 629, at p.633 and 654). The House of Lords' decision, however, concerns the nature of the liability of the director under the general law. The indemnity played no part in the reasoning of either Lord Halsbury or Lord Davey.

138. The claimants also refer to the fact that *Re Sharpe* was not cited in *Dovey v Cory*. However, *Flitcroft's Case* and *Lands Allotment* were, and (as noted above) Lord Davey referred to *Leeds Estate v Shepherd*, in which the trustee-like nature of director's duties in connection with payment of dividends was expressly considered, but liability was nevertheless held to be fault-based.

***The position by 1901***

139. On the basis of the above cases, by the end of the 19th Century I consider that the law was established to be as follows. First, directors, although not trustees, were to be treated as if they were trustees in relation to the company's funds. Second, if they knew the facts which constituted an unlawful dividend, then they would be liable as if for breach of trust irrespective of whether they knew that the dividend was unlawful. Third, however, if they were unaware of the facts which rendered the dividend unlawful then provided they had taken reasonable care to secure the preparation of accounts so as to establish the availability of sufficient profits to render the dividend lawful, they would not be personally liable if it turned out that there were in fact insufficient profits for that purpose. Fourth, they were entitled to rely in this respect upon the opinion of others, in particular auditors, as to the accuracy of statements appearing in the company's accounts. Fifth, nothing in the authorities cited as the leading authorities for the strict-liability view (*Flitcroft's Case*, *Lands Allotment* and *Re Sharpe*) undermines that conclusion.

***Cases subsequent to Dovey v Cory***

140. One of the authorities cited by Lord Hope in *Paycheck* for the proposition that directors' liability may be fault-based was *Re City Equitable Fire Insurance Co Ltd* [1925] 407, per Romer J at p.426. In that passage of his judgment, however, Romer J was concerned with the liability of directors, generally. Having noted that directors are sometimes said to be trustees, and commented that this was only true if it meant no more than that they stood in a fiduciary relationship with the company, he declined to attempt a comprehensive description of the duty of directors "whether by analogy or otherwise". The issue with which I am concerned was not discussed in the judgment.

141. In *Selangor United Rubber Estates Ltd v Cradock (No.3)* [1968] 1 WLR 1555 (another case cited by Lord Hope in *Paycheck* as authority for the strict liability view), at p.1575C-D, Ungoed-Thomas J said this:

> "However much the company's purposes and the directors' duties, powers and functions may differ from the purposes of a strict settlement and the duties, powers and functions of its trustees, the directors and such trustees have this indisputably in common — that the property in their hands or under their control must be applied for the specified purposes of the company or the settlement; and to apply it otherwise is to misapply it in breach of the obligation to apply it to those purposes for the company or the settlement beneficiaries. So, even though the scope and operation of such obligation differs in the case of directors and strict settlement trustees, the nature of the obligation with regard to property in their hands or under their control is identical, namely, to apply it to specified purposes for others beneficially. This is to hold it on trust for the company or the settlement beneficiaries as the case may be. That is what holding it on trust means. That is why a misapplication of it is equally in each case a breach of trust."

142. This was not a case, however, where the question whether a director's liability was strict or fault-based was in issue, and the only case referred to by Ungoed-Thomas J

(of those I have set out above) was *Lands Allotment*. The nature of the director's liability was relevant only to the question how other defendants could be made liable as constructive trustees.

143. Another of the cases cited by Lord Hope as part of the modern trend pointing towards strict liability is *Belmont v Williams*. This case is, however, of little help. Although (at p.404, in the passage referred to by Lord Hope) Buckley LJ found that a person who is unaware of the facts constituting the unlawful action has a defence, while a person who knows the facts but honestly believes the conduct is lawful does not, he was there discussing the knowledge required to render a person liable for the tort of conspiracy, not whether the liability of a director who procures that the company enters into a transaction in breach of s.54 (financial assistance) is strict or fault based. At p.405, Buckley LJ simply refers to the fact that directors are treated as trustees of the property of the company. But this does not advance the debate, because in *Kingston* and the other cases cited above from the 19th century, it is accepted that directors are treated as trustees, yet their liability is nevertheless not regarded as strict.

144. The claimants rely on *Re Duckwari Plc (No.2)* [1999] Ch 253, a case involving an acquisition by the company from a director in breach of s.320 of the 1985 Act. Under s.322(3)(b) the director was liable to indemnify the company for any loss arising from the transaction. The question which arose for decision was whether loss was to be assessed at the time of the transaction (in which cases there was none) or subsequently, after there had been a large diminution in the value of the property. The Court of Appeal held it was the latter. In reaching that conclusion, reliance was placed, first, on *Lands Allotment* and *Belmont Finance* for the proposition that directors, while not being trustees, are treated as trustees of assets which are in their hands or under their control and, second, on the rule that if a trustee applies trust moneys in the acquisition of an unauthorised investment, he is liable to restore to the trust the amount of the loss incurred on its realisation: (see Nourse LJ at p.262). The claimants point to a passage at p.265 of the judgment of Nourse LJ:

> "It is well recognised that the basis on which a trustee is liable to make good a misapplication of trust moneys is strict and sometimes harsh, especially where, as here, there has been a huge depreciation in the value of the asset acquired."

145. It is important to note, however, that the question whether a director's liability (in the first place) was strict, or based on some element of fault, was not in issue in the case. The reference to "strict" in that passage of Nourse LJ's judgment was referring to the strict nature of the rule as to causation. None of the cases I have referred to above, which addressed the nature of a director's liability for causing a company to pay an unlawful dividend, was cited in *Duckwari*. Moreover, there was no doubt that the director was aware of all of the facts which rendered the transaction unlawful, so on the basis of the test applied in those cases, no issue arose in any event. The case is therefore of no assistance.

146. The claimants also rely on *Re Loquitur* [2003] EWHC 999 (Ch). Etherton J, having concluded that the dividend was unlawful, said: "Directors who cause their company to make ultra vires payments are in the same position as trustees who make payments in breach of trust, and are liable to make good the money misapplied", citing *Lands Allotment, Flitcroft's Case, Re Sharpe, Selangor* and *Belmont*. None of the cases I

have referred to above which concluded that, while directors are liable as if they were trustees, nevertheless liability is fault based, was referred to or cited in *Loquitur*. *Re Marini Ltd* [2003] EWHC 334 (Ch), also cited by the claimants, is similarly of no help. There was no discussion of the nature of the directors' liability, the only questions being whether the whole of the dividend was unlawful, or only that part of it which exceeded distributable profits of the company, and whether the directors were able to rely on the defence under s.727 of the 1985 Act (see [36] of the judgment of HHJ Richard Seymour QC).

147. The relevant authorities were considered by Nelson J at first instance in *Bairstow v Queen's Moat Houses plc* [2000] BCC 1,025. At p.1,031F-G, having cited from Lindley LJ in *Re Sharpe*, he said: "No repayment of an improperly paid dividend will however be ordered where the payment was made without fault on the part of the directors". At p.1,032, however, he was equivocal as to whether this was a necessary element in the cause of action, or an element in a claim for relief. Having referred to *Kingston Cotton Mill*, *Leeds Estate v Shepherd* and *Dovey v Cory*, he said "Whether expressed as a condition for establishing primary liability, or as relief from such primary liability, I am satisfied on the authorities that repayment of an unlawful dividend cannot be ordered against a director in an action for breach of trust where the payment was made with no fault on the part of the director".

148. So far as the standard of conduct required of a director was concerned, Nelson J noted that the statements 19th Century cases as to the standard of care required of directors needed to be considered in the light of developments in the law relating to directors' duties, such that a director would be liable to repay an unlawful dividend if: (1) he knew that the dividend was unlawful, whether or not that actual knowledge amounted to fraud; (2) he knew the facts that established the impropriety of the payments, even though he was unaware that such impropriety rendered the payment unlawful; (3) he must be taken in all the circumstances to have known all the facts which rendered the payment unlawful; or (4) he ought to have known, as a reasonably competent and diligent director, that the payments were unlawful.

149. Although Nelson J's decision was appealed (and his conclusion as to the grant of relief from liability under s.727 of the 1985 Act was overturned), the Court of Appeal did not discuss, or interfere with, Nelson J's conclusions in this respect.

150. In *Clydebank Football Club v Steedman* 2002 SLT 109, the question was whether the disposal of certain properties constituted a "distribution" within s.263 of the 1985 Act. It was held that they did not. Nevertheless, Lord Hamilton went on to consider whether, if they had done, the directors of the company would be liable in respect of them. At [79], he recited the submission made to him as follows: "it was sufficient to bring home liability against the defenders that (1) there had been an unlawful distribution, and (2) the defenders had as directors participated in the decision which had resulted in that distribution". He then said that no authority had been cited to him for that proposition. He rejected it, concluding: "It is plain, in my view, that directors are liable only if it is established that in effecting the unlawful distribution they were in breach of their fiduciary duties, (or possibly of contractual obligations, though that does not arise in the present case). Whether or not they were so in breach will involve consideration not only of whether or not the directors knew at the time that what they were doing was unlawful but also of their state of knowledge at that time of the material facts. In reviewing the then authorities Vaughan Williams J in *In*

*re Kingston Cotton Mill (No.2)* [1896] Ch 331, 427: 'In no one of [the cases cited] can I find that directors were held liable unless the payments were made with actual knowledge that the funds of the company were being misappropriated or with knowledge of the facts that established the misappropriation'. Although this case went to the Court of Appeal, this aspect of the decision was not quarrelled with (see [1896] 2 Ch 279)."

151. Since the cases suggesting that liability is strict were not cited to him, Lord Hamilton's decision is of limited assistance. The passage from his judgment including the quotation from Vaughan Williams J was approved by Lord Walker JSC in *Progress Property Co Ltd v Moore* [2011] 1 WLR 1, at [32]. In that case, it was claimed that the transfer of shares from the company to a subsidiary of its majority shareholder was at a gross undervalue and had therefore been ultra vires and unlawful as an unauthorised return of capital. The Judge held that it was a genuine sale, even if at an undervalue and not an unauthorised distribution of capital. The Court of Appeal dismissed an appeal against that decision and the Supreme Court dismissed a further appeal.

152. Lord Walker JSC considered that the essential question was one of characterisation of the transaction and that this involved a consideration of all the relevant facts, which sometimes include the state of mind of those orchestrating the corporate activity. In this context, he said (at [28]): "sometimes their states of mind are totally irrelevant. A distribution described as a dividend but actually paid out of capital is unlawful, however technical the error and however well-meaning the directors who paid it." It is important to note that he was not addressing, in this passage, the liability of directors who procure the company to pay an unlawful dividend. He was addressing only the lawfulness of the dividend itself. Given his endorsement of the passage from Vaughan Williams J's judgment in *Kingston Cotton Mill* four paragraphs later, he cannot have intended to conclude that directors' liability in such a situation is strict. Similarly, however, I think it unlikely that in endorsing Vaughan Williams J he intended to resolve the issue that was left open in *Paycheck*. *Progress Property* was argued after argument had been heard, but before judgment was handed down, in *Paycheck*. In *Paycheck* itself, at [119], Lord Walker commented that "Contravention of [s.265 of the 1985 Act] is a statutory wrong giving rise to strict liability, and anyone who is in a position to contravene it is likely to be in a fiduciary position." This comment was made, however, in the context of considering whether the defendant was a shadow director. Lord Walker made no reference to the competing lines of authorities identified by Lord Hope so far as the question of strict or fault-based liability was concerned. Nor did he suggest that there had been full argument on the point. In those circumstances, I do not believe that Lord Walker was intending, by this comment, to resolve the issue left open by Lord Hope.

153. For completeness, I was also referred to *Madoff Securities International Limited v Raven* [2013] EWHC 3147, in which Popplewell J, at [197] to [200] and [205] referred to both *Progress Property* and *Paycheck* and the rival lines of authority there identified, but did not need to decide whether liability for an unlawful distribution of capital was strict or fault based.

### *Arguments for strict liability put forward in Paycheck*

154. The first point made by Lord Hope was that, accepting that liability of directors for unlawful dividends was treated as fault-based in *Davey v Cory*, the trend of authority since then suggested that liability was strict. Having reviewed the authorities in detail above, I do not believe that there is such a trend in the modern authorities. Apart from *Bairstow v Queen's Moat Houses* (in which Nelson J concluded that fault on the party of a director was necessary before he or she could be made liable to repay an unlawful dividend) none of them has addressed the question which was specifically dealt with in the 19th Century cases I have referred to above (namely whether a director who is – without fault – unaware of the facts which render the dividend unlawful, liable to repay the dividend). To the extent that there is any assumption in any of the more recent cases that liability is strict, that has been made without reference to the 19th Century cases which established the opposite. Moreover, none of them has established a reason for overruling or distinguishing *Dovey v Cory*, a decision of the House of Lords.

155. The second point made by Lord Hope was that the cases suggesting liability was fault-based pre-dated the introduction of the provision which is now s.1157 of the 2006 Act, so that provision was not available at the time of the earlier decisions. The "whole point", he said, of the right to claim relief was to enable the court to mitigate the potentially harsh effect of being held strictly liable.

156. Although it is true that the provision was first introduced as s.32 of the Companies Act 1907, I do not believe that its enactment had the consequence suggested by Lord Hope. In the first place, it would be surprising if a provision intended to be for the benefit of company directors had the consequence of making them strictly liable for matters which, previous to its enactment, would have required proof of fault. The most that can be said is that in many cases after its enactment (as in *Paycheck* itself) the basis of liability became academic because the same result could be reached either through finding that liability was fault-based or by application of the defence. Second, there are at least two ways in which s.32 alleviated the harshness of the existing law as established in the cases to which I have referred: (1) it permitted the court to relieve a director from liability for negligence, and (2) it permitted relief from liability that was strict in the sense that a director knew all of the facts which rendered a dividend a breach of trust, but in reliance on legal advice believed that it was nevertheless lawful. Accordingly, it was not the case that the sole purpose of the provision was to alleviate the hardship of strict liability (and certainly not if strict liability is interpreted to mean that a director can be liable even if he, without fault, is unaware of all the facts which render the dividend unlawful). It is also important to note that, contrary to the assumption of Lord Hope, the factors taken into account under s.1175 do not necessarily precisely reflect those taken into account in determining whether a fault-based breach of duty has been committed (given the need to consider whether in all the circumstances of the case the director ought fairly to be excused: see section E11 below)

### *Conclusion*

157. For the above reasons, I conclude that the law on the issue whether liability is strict or fault-based remains the same as it was at the end of the 19th Century (as summarised in paragraph 139 above).

158. I consider this to be consistent with first principles, so far as it applies to the payment of unlawful dividends. The question whether there are sufficient distributable profits may turn on fine questions of accounting judgment. Directors are not required to be accountants and the comments of Lord Davey and Lord Halsbury LC in *Dovey v Cory* as to directors being entitled to rely on the judgment of others whom they appoint to carry out specialist financial roles within the company are as pertinent today as when they were made in 1901.

159. The only modification to the position reached at the end of the 19th Century is as to the standard required of directors, which is as set out by Nelson J in *Bairstow*.

## E5. Was there in fact a declaration of a dividend at a properly convened board meeting?

160. The claimants' first line of attack on the Distribution is that there was never any properly convened board meeting at which the matters required by Part VIII of the 1985 Act were considered.

161. They contend that the directors had made a conditional decision, on 29 August 2007, to proceed with the demerger and that they thereafter proceeded as if the board had given authority for the Distribution; the 12 October 2007 meeting was seen as just a procedural step, not a meeting at which any relevant matter needed to be or was considered; there was accordingly no decision of any kind, let alone a board decision, which might have amounted to a decision to recommend a dividend for the purposes of s.270 of the 1985 Act.

162. Specifically as regards the alleged meeting of the directors of BHUK on 12 October 2007, the claimants contend that:

i) No notice was given to all directors, relying on Mr Beckett's evidence in his witness statement that although he knew that there was to be a meeting on the day, he "…was not requested to attend presumably because I was not required for a quorum", and the absence of any evidence that notice was given to Mr Kavanagh;

ii) Various factors render the minutes "unreliable": they were prepared by Mr Joyce, who was not at the meeting; a revised version was sent to Mr Beckett only after the meeting, and no-one could explain why; also no-one could explain why Mr Kavanagh's name was removed and replaced with Mr Whitelock's (the best Mr Joyce could do was 'guess' that this was at the request of Mr Beckett); and the time appearing on the minutes (11:40am) is after the time appearing on the minutes of the board meeting of BHUH (11:30am), whereas the latter meeting was supposedly consequent upon the former; and

iii) There is no evidence of the Interim Accounts having been circulated by Mr Beckett or Mr Joyce to any of the directors in advance of the meeting, to allow for proper consideration of them and the evidence of Mr Fielding was that the meeting lasted no more than about 10 minutes. Accordingly, there was never any proper consideration of the Interim Accounts.

163. BHUK had adopted as its articles Table A of the Companies (Tables A to F) Regulations 1985. By article 102 the power to declare dividends was vested in the company by ordinary resolution, subject to the provisions of the 1985 Act, provided that no dividend should exceed the amount recommended by the directors.

164. The claimants do not dispute that a dividend was in fact declared by BHUK. They could not realistically do so in light of the written resolution of BHUK and the minute of the board minute of BHUH (BHUK's sole shareholder) both dated 12 October 2007. Their complaint must therefore be understood as being directed at the proviso that no dividend could be declared which exceeded the amount recommended by the directors.

165. It is important to distinguish this complaint – which relates solely to whether there was in fact any decision to recommend a dividend – from the question whether the statutory requirements of Part VIII of the 1985 Act were complied with (which I consider below). The distinction is important because in asking whether directors *in fact* reached a determination, no particular formality is required. For a determination by directors to be effective, it is sufficient that by the time of the Distribution all the directors had in fact concurred or informally acquiesced in it: see *Runciman v Walter Runciman* [1992] BCLC 1084, per Simon Brown J at p.1092c-d. In relation to the requirements under Part VIII of the 1985 Act on the other hand, such as the need for relevant accounts establishing sufficient distributable profits, strict compliance is necessary and it is not possible to waive the requirement, for example where it is established that relevant accounts could have been prepared demonstrating sufficient distributable profits: see *Bairstow v Queens Moat House* [2002] BCC 91, per Robert Walker LJ at [36].

166. The claimants submit that the following are requirements of the 1985 Act, which must be strictly complied with: that the directors hold a meeting to recommend the dividend; that the relevant accounts are the *company's* accounts, in the sense of being adopted by the company, and that the directors actively give consideration to the relevant accounts in order to conclude that there are sufficient distributable profits to enable the dividend to be declared.

167. I reject these submissions. There is no express reference to any of these matters in Part VIII of the 1985 Act. For private companies the requirements are stated in the passive: the amount of the distribution which may be made "is determined by reference" to matters as stated in the company's accounts; and where interim accounts are used, they must be such as are "necessary to enable a reasonable judgment to be made". The reference to the "company's accounts" does not impose any requirement, in relation to interim accounts, that they be laid before the company, whether through its directors or in a general meeting. It merely denotes that they must be accounts relating to the company. This contrasts with the requirements relating to annual accounts, which must have been "laid" in respect of the last preceding accounting reference period.

168. I accept that s.263(5), in permitting "the directors", in certain circumstances, to treat a profit (or loss) made before 22 December 1980 as realised (or unrealised), contemplates that it will be the directors that make the determination as to available profits. That is not the same thing, however, as imposing a mandatory requirement, in order for a dividend to be lawfully declared by a private company, that directors actively reach a determination as to the amount of realisable profits. Of course, that is not to deny that it is important for directors actively to consider whether the company has sufficient distributable reserves, or to ensure that there are accounts that comply with the requirements of Part VIII and properly consider them, because, if they fail to do so and the requirements of Part VIII are in fact not met, then it is likely to be difficult for the directors to escape personal liability.

169. I am satisfied on the evidence that each of the directors knew of and approved the Distribution. That was the evidence of each of Mr and Mrs Fielding, Mr Whitelock and Mr Beckett, and is supported by the following:

i) There is no doubt that Mr and Mrs Fielding approved the Distribution, given that Mrs Fielding signed the minutes of the directors' meeting of BHUH approving the written resolution dated 12 October 2007, and Mr Fielding signed the written resolution.

ii) Nor is there any doubt that Mr Beckett approved the Distribution: he was centrally involved in the preparations for it, including the production of the Interim Accounts and liaising with Mr Joyce over the drafting of the board minute of 12 October 2007.

iii) Those minutes record Mr Whitelock as being present. In his first witness statement he said that he did not specifically recall the meeting, but believed that he did attend. In cross-examination he purported to have a clear memory of the meeting. I consider it more likely that the supposed improvement in his memory is the product of having familiarised himself with the documents as opposed to actual recollection. Nevertheless I find that he was present at the meeting, principally because I see no reason to doubt the accuracy of the minutes in this regard. There was clearly a deliberate choice made to add him as an attendee at some point between the first and second drafts of the minute. The natural inference is that he was added as attendee either because it was known that he would be attending or that he had attended. In any event, I have no doubt that Mr Whitelock was fully aware of and approved the Distribution at the time. He was present at the meeting on 29 August 2007 at which the board had approved (even if subject to the need to take advice) that the demerger process be commenced, and as a director of Vital he cannot have failed to be aware of the progress of the transaction between 29 August and 12 October 2007.

iv) Mr Kavanagh has not given evidence, citing as a reason (in a letter to Mr Fielding dated 4 July 2018) the stress that he observed the Fieldings endured during the Ultraframe litigation. He too had approved the commencement of the demerger process at the 29 August 2007 board meeting and I find it inconceivable, given the scale of the restructuring, that he was not kept aware of its progress between then and October.

170. Accordingly, applying the principle in *Runciman*, there was a determination reached by the directors to declare a dividend. The amount of that dividend was always contemplated to be the value of BHUK's shareholding in Vital. Even if the claimants are correct that there was no properly convened board meeting on 12 October 2007, or that the directors present at that meeting did not adopt or adequately consider the contents of the Interim Accounts, I therefore find that the declaration of the dividend in specie by the written resolution of the company's sole shareholder nevertheless complied with article 102.

171. In any event, the proviso in article 102 that the company by ordinary resolution could not declare a dividend in a sum greater than that recommended by the directors was one which could be waived by all the shareholders acting unanimously, on the *Duomatic* principle, named after the decision in *Re Duomatic Ltd* [1969] 2 Ch 365. The sole shareholder, BHUH, is to be taken to have done so when it resolved to declare the dividend in specie of the share in Vital.

172. In light of this conclusion it is strictly unnecessary to deal with the claimants' detailed points in support of their allegation that no properly convened board meeting took place. I nevertheless set out my conclusions in this respect in the following paragraphs.

173. I agree with the defendants that the correct starting point is s.249 of the 2006 Act, which provides that minutes recorded in accordance with s.248 purporting to be authenticated by the chairman of the meeting are evidence of the proceedings at the meeting and that where minutes have been made in accordance with that section then, until the contrary is proved, the meeting is deemed duly held and convened, and all proceedings at the meeting are deemed to have duly taken place (and that the onus is on those wishing to displace the minutes to overturn the presumption: *Sneddon v MacCallum* [2011] CSOH 59). It is therefore for the claimants to displace the presumption that the meeting was duly convened and that the proceedings recorded in the minutes took place.

174. So far as the alleged lack of notice is concerned, the defendants contend that this point was not pleaded. The claimants point to paragraph 28 of the re-re-amended particulars of claim. This alleges that "it is to be inferred that the meetings [of 4 October 2007 and 12 October 2007, all relating to the demerger] did not take place, and the resolutions were not passed, because of the following facts and matters…" There then follows a series of sub-paragraphs containing particulars of that primary allegation, sub-paragraph (7) of which alleges that "if the meeting had been properly convened, it would not have been possible for Addleshaw Goddard to know in advance when producing template minutes which directors would choose to attend which board meetings, or which directors would chair which meetings…" In my judgment, this oblique reference to the meetings being "properly" convened is not an allegation that that the meeting of BHUK's directors on 12 October 2007 occurred without notice having been given to all the directors. Had such an allegation been expressly made, then it may well be that the defendants would have sought to adduce additional evidence to deal with it. Accordingly, I do not think it is open to the claimants to advance this argument. It is open to them on this pleading, however, to advance their primary case that there was no meeting at all.

175. In any event, the fact that there is no evidence of notice of this meeting being given to the directors is unsurprising in light of the lack of surviving documentation in relation to board meetings generally, and the absence of evidence of notice being given to directors in respect of *any* board meeting. In these circumstances, and after such a long time, the absence of evidence does not indicate that there was in fact no notice. No particular form of notice is required, and it is clear from the passage in Mr Beckett's witness statement relied on by the claimants that he knew the meeting was to take place, i.e. that he had received notice of it. I also find nothing untoward in the addition, then removal, of Mr Beckett's name from the list of attendees. Again, the absence of any explanation is not surprising given the passage of time.

176. I do not accept the points made by the claimants as to the supposed unreliability of the minutes (see paragraph 162(ii) above). There is nothing untoward, or even unusual, in minutes for a formal board meeting being prepared by the company's solicitor in advance, identifying those matters which the board should take into account in order to comply with their duties. The claimants cited *Re AG (Manchester) Limited* [2008] BCC 497, per Patten J at [101], for the proposition that a meeting of directors convened to consider a declaration of a dividend cannot merely rubber-stamp a decision taken beforehand. That case concerned, however, a company which simply made payments upon request by the director for cash, or to meet a schedule of bonus payments agreed by him. There was never any consideration given to whether the payments could be justified as dividends by reference to the company's distributable reserves as shown by relevant accounts. It was in that sense that each of the dividend payments was "pre-determined". The decision provides no assistance in the circumstances of this case.

177. A large number of documents were prepared for the transaction, and were required to be signed on 12 October 2007. It is not surprising if minor errors appeared or some were not signed in the correct order. The fact that Mr Joyce produced a revised minute, identifying different attendees from the first draft, suggests he must have been given a credible reason at the time as to why Mr Kavanagh and Mr Beckett were not to be at the meeting. It is understandable that, after more than 11 years, he cannot remember what led to the change.

178. In relation to the suggestion that there was never any proper scrutiny of the Interim Accounts, I accept that it is unlikely there was lengthy scrutiny at the meeting itself. The meeting lasted no more than 10 minutes. However, the Interim Accounts were an updated form of a document that would have been very familiar to the directors. The description of assets and liabilities was largely unchanged in the management accounts from month to month. The aspects that were new, and required attention, were the line items "profit and loss account", "revaluation reserve" and those relating to the dividend from K2 Glass. It would not have taken long to note these entries. Moreover, the meeting was the culmination of a process which had been known to the directors for some weeks (at least since the meeting on 29 August 2007). The draft minutes sent to Mr Fielding on 1 October 2007 expressly referred to the revaluation of Vital, the dividend from K2 Glass and the conclusion that distributable reserves were greater than £10.48 million (being the value of Vital). In these circumstances, I find it inherently likely that there was discussion among the directors on these matters prior to the formal board meeting on 12 October (even if - which I address below – the Interim Accounts had not already been discussed at a board meeting in September).

179. I note that Mr Whitelock, in his oral evidence, said that he ran through the calculation of distributable reserves with Mr Fielding in the meeting, and that he had a conversation with Mr Beckett about the Interim Accounts prior to the meeting. I am sceptical that he has an actual recollection of these matters for the reasons given in paragraph 169(iii) above but (for the reasons just given) I consider it likely that there were such discussions prior to the meeting.

180. The defendants also contend that the Interim Accounts had already been presented to, and discussed by, the board at its usual monthly meeting at the end of September 2007.

181. The claimants contend that no such meeting took place, because: there is no contemporaneous record of it; the only reference to it in witness statements was a passing reference in Mr Whitelock's evidence to monthly meetings in June, July and September 2007 whereas, if it had been the occasion when the Interim Accounts were presented to the board then it would have featured in the witnesses' narrative of events relating to the Distribution; the reference in minutes of the board meeting on 12 October 2007 to a copy of the August management accounts being "produced" to the board is inconsistent with them having been discussed at an earlier board meeting; and it is inconsistent with contemporaneous documents, including an email from Mr Joyce to Mr Beckett of 1 October 2007 in which he asked for the date of the "last board meeting at which the revaluation was agreed", and the minutes of the BHUK board meeting 12 October 2007 which refers to the board's agreement as to the revaluation of Vital at its "previous" meeting.

182. These are powerful arguments but I find on balance that there was a board meeting sometime around the end of September at which the directors reviewed the management accounts for August 2007. In the first place, I am satisfied that it was the usual practice of the board of BHUK to meet monthly in order to consider, among other things, the management accounts for the previous month. Second, the fact that no minute of a meeting in September is available is of little significance given that hardly any minutes of monthly meetings have survived. The minutes of the regular monthly minutes would not ordinarily have been prepared by, or provided to, Addleshaw Goddard so – unlike the minutes relating to the Distribution – would not have survived via that route. Third, Mr Joyce would not have been involved in the regular monthly meetings, so when he referred in his email of 1 October 2007 to the "last" board meeting at which the revaluation of Vital was agreed (i.e. the meeting on 29 August 2007) he was probably referring to the last meeting of which he was aware. Fourth, the Interim Accounts, though only provided to Mr Joyce on 8 October 2007, were themselves dated 20 September 2007, leaving plenty of time for them to be considered by the board in the intervening period. The fact that the only version that remains is the one faxed to Mr Joyce is consistent with the fact that the only documents to have survived, generally, are those that were passed to third parties who retained them. Fifth, the reference in the minutes of the meeting dated 12 October 2007 to the revaluation of Vital having been agreed by the board "at its previous meeting" is inconclusive, since there is in evidence a board meeting of BHUK dated 4 October 2007 approving the transfer of shares in the company. It is clear, therefore, that the phrase "previous meeting" cannot have been used in the sense of the "immediately prior meeting".

183. For the above reasons, I conclude that there was a board meeting of BHUK on 12 October 2007 at which at least brief consideration was given to the Interim Accounts and at which the board determined to recommend a dividend in specie of the share in Vital.

## E6. Did the Interim Accounts comply with s.270?

184. The claimants contend that the Interim Accounts did not comply with s.270(4) because they did not enable a reasonable judgment to be made as to the amount of the assets, liabilities, profits, losses, provisions of the kind mentioned in paragraphs 88 and 89 of Schedule 4, share capital and reserves of BHUK.

185. The defendants contend that the requirements for interim accounts are less onerous than those for statutory accounts. As pointed out in Buckley on the Companies Acts (1985), paragraph 272.6, "there are no requirements for the form or content of interim accounts of private companies" beyond the requirement in s.270(4) set out above. This is to be contrasted with the position in relation to public companies, where the interim accounts must be "properly prepared", so as to give a "true and fair view" of the profit and loss of the company for the period: s.272(3).

186. They also referred me to a passage from Hansard relating to the introduction of ss.171-172 of the 1985 Act, which applied the same test for accounts used in order to determine whether a company could acquire its own shares out of profits as that applied to interim accounts for private companies in the context of distributions, namely that they should enable a "reasonable judgment" to be made. Speaking for the government, on presenting the bill to the House of Commons, Mr Eyre described the sole policy change of any significance being: "it requires the accounts by reference to which available profits are determined to be such as to enable a reasonable – rather than a proper, as at present – judgment of the amount to be made. This imposes a less rigorous but reasonable standard by which the matter can be judged."

187. The claimants on the other hand point to a passage in the judgment of David Richards LJ in *BTI v Sequana* [2019] EWCA Civ 112, at [23], where he referred to the need for interim accounts to be "properly prepared in accordance with sections 395-397" (as well as being such as to enable a reasonable judgment to be made as to the items mentioned in section 836.) It was, however, common ground that there was no difference – for the purposes of that case – between the requirements for annual accounts to show a true and fair view and interim accounts to enable a reasonable judgment to be made of the relevant items.

188. This case does not turn, in my view, on the precise formulation of the test for Interim Accounts. While, as I have noted above, the formal requirements relating to the accounts of public companies, including that they be properly prepared so as to give a true and fair view, do not apply to interim accounts for private companies, it must nevertheless be a relevant factor, when asking whether the accounts do enable a reasonable judgment to be made, to consider whether they do give a true and fair view of, for example, the profit and loss for the company for the period in question.

189. The question as to what constitutes a "reasonable judgment" was explained in *Re Paycheck Services 3 Ltd* [2009] Bus LR 1, per Mark Cawson QC, at [197] (a decision

which was overturned, on other grounds, in the Court of Appeal, itself upheld on a further appeal to the House of Lords):

> "I consider that the references in section 270(4) and paragraph 89 of Schedule 4 to the 1985 Act to "reasonable judgment" and to "reasonably necessary" point against an intention to render a dividend unlawful if it is only with hindsight that it can properly be said that provision ought to have been made for a particular liability. In my judgment, what the relevant provisions require is the making of a reasonable judgment based on facts as reasonably perceived, or that would have been ascertained by reasonable inquiry. Thus, for example, if there was no reasonable means of knowing that a debt was a bad debt (eg because it was reasonably not known that the debtor was insolvent) then it does not seem to me that the relevant provisions intended to, or did in fact provide, that a dividend paid in these circumstances was unlawful. However, the necessary consequence of Mr Green's argument is that it would be."

190. He continued, at [198]:

> "Further, in relation to liabilities of the kind specified in paragraph 89 of Schedule 4 to the 1985 Act, I consider that, based on the language thereof read together with that of section 270(4) of the 1985 Act, there is only a requirement to make provision for the purposes of the "interim accounts" if, on a reasonably objective view of the facts as known or reasonably ascertainable by those taking the decision to pay the dividend, the liability is likely (in the sense of being more likely than not) to be incurred."

191. The claimants' first criticism of the Interim Accounts is that they comprised just two sheets of paper, and that it was necessary – in order to understand the entries – to have regard to extrinsic evidence and potentially other documents (such as monthly management accounts and forecasts) to establish the adequacy of the accounts. For example, the aggregate amount of the loan due from K2 Con was in fact £2,187,144, but this is only arrived at, by reference to the figures in the Interim Accounts, by amalgamating the following: (1) the figure of £1,663,770.41 recorded as due from K2 Con; (2) deducting £1,042,161 being part of a balance recorded as "Internal Purchase Accounts"; and (3) adding the £1,565,535 recorded as due from TBG. A similar point arises in relation to the value ascribed to BHUK's investment in TBG.

192. The claimants submit that this is inconsistent with the guidance in *Vardy Properties (Teeside) Limited v HMRC* [2012] UKFTT 564 (TC) at [53] and [56] that interim accounts must be a single document setting out all relevant matters. The comments of the First Tier Tribunal in that case must be seen, however, in context. It was a case where the directors had purported to satisfy themselves as to the ability to declare a dividend by reference to various transaction papers, and the confirmation they had received that a certain amount in cash was held by the company as a result of a share issue. There was nothing at all which resembled accounts. The FTT's conclusion, at

[63], was that s.270 "…requires the production of an identifiable contemporaneous single document which records the required items under section 270(2) CA 85. The degree of detail and formality of that document may vary, depending on the context, but a single document is, in our view, required in all cases."

193. The Interim Accounts did, on their face, record the assets, liabilities, profits and losses, share capital and reserves of BHUK. They indicated distributable profits of £804,243.31, plus a revaluation reserve of £9.73 million consequent upon the revaluation of Vital. I do not regard the fact that the justification for these figures was to be found in other documents (for example, cash flow forecasts of subsidiary companies justifying a particular carrying value for the investment in them, or debts due from them) as a reason for concluding that the Interim Accounts were deficient. Even if it is necessary for the accounts to be contained in a single document (which I do not accept is necessary in all circumstances), that would not preclude supporting material being found in other documents.

194. I agree with the FTT that the degree of detail and formality required will depend on the context. In the present case, the context includes that BHUK was a non-trading holding company, whose assets consisted mostly of investments in subsidiaries, and whose liabilities were mostly to its shareholders or subsidiary companies. By its nature, therefore, it was to be expected that its management accounts would be relatively simple. The context also includes the fact that the audience was the directors, who were already familiar with the format in which the management accounts were presented, and what lay behind them, having been presented on many previous occasions with monthly management accounts which were, like the Interim Accounts, derived from the Navision accounting software used by the company.

195. In my judgment, the level of detail in the Interim Accounts was sufficient to satisfy the requirements of s.270(4) on the facts of this case.

196. For the same reasons, I consider that the fact that it was necessary to amalgamate different entries to identify the net value of the investment in TBG and the net value of the loan due from K2 Con does not invalidate the Interim Accounts for the purposes of s.270(4).

197. Leaving aside for the moment the claimants' complaints that the value of certain assets was materially overstated, and certain provisions were wrongly excluded, the claimants also contend that the Interim Accounts failed to enable a reasonable judgment to be made in relation to its assets because of mis-descriptions of certain assets.

198. The most significant of these relate to SGI, TBG and K2 Con. First, it is common ground that the entry of £250,000 as the carrying value for BHUK's investment in the shares of SGI is wrong (at least) because, as to £150,000 of that sum, it should have been recorded as part of the value of BHUK's investment in the shares of TBG. Second, it is also common ground that the assets and liabilities of TBG had, as of 1 July 2006, been transferred to K2 Con, but the Interim Accounts recorded a loan due from TBG in the sum of £1,565,535.20. Third, (at least on one version of the defendants' case) the resulting value for TBG should in any event be recorded as added to the value of BHUK's investment in K2 Con (which was recorded at its historic cost of £1,000).

199. I will deal with this aspect of the claimants' case on the assumption that the misdescriptions did not have an impact on the aggregate value shown in the Interim Accounts for, on the one hand, debts due from subsidiaries and, on the other hand, the value of investments in subsidiaries. (I address separately below the claimants' case that the value of the investments in and amounts due from certain subsidiaries was materially overstated.)

200. The question is whether the fact of such misdescription (ascribing an asset as the value of shares in, or a debt due from, X, when it should have been Y) means by itself that the accounts do not comply with s.270(4). In my judgment, it does not, for two reasons. First, had the accounts been statutory accounts the individual items under the headings "investments in subsidiary companies" and "debts due from subsidiary companies" would not have been set out. All that would have appeared would have been aggregate figures for both. *A fortiori* the aggregate figures are sufficient to enable a reasonable judgment to be made as to the assets, liabilities etc of the company. Second, the purpose of having accounts which enable a reasonable judgment to be formed as to the assets, liabilities etc of the company, is so that a determination can be made as to whether a dividend would be paid out of profits and as to whether it would render the company insolvent. For that purpose it is sufficient that the aggregate figures for debts due from subsidiaries and investments in subsidiaries are identified.

201. The defendants, in addition, rely on an opinion of Mr Martin Moore QC dated 21 April 2008 which considered whether earlier opinions of Leonard Hoffmann QC (later Lord Hoffmann) and Mary Arden (now Lady Arden JSC) in 1983 and 1984 and by Mary Arden QC in 1993 held good in light of the provisions of European Directives and Regulations governing the preparation and audit of financial statements and/or the requirements of the Companies Act 2006. The earlier opinions (which Mr Moore QC described as having "almost iconic status") concluded that in determining whether accounts satisfied the legal requirement that they show a true and fair view, the Courts relied heavily upon the ordinary practices of professional accountants and that compliance with generally accepted accounting principles would be prima facie evidence of satisfaction with the standard (and vice versa). The earlier opinions also concluded that reasonable businessmen and accountants differed over the degree of accuracy or comprehensiveness, and that there may be more than one view of a financial position, any of which could be described as true and fair. In *BAT Industries plc v Sequana*, at first instance, [2017] 1 BCLC 453, at [372], Rose J referred with apparent approval to Mr Moore QC's opinion. At paragraph 16 of that opinion, he cited *Jeanique International Holdings Limited v Foreshew* [2001] 3 WLUK 438, as an example of a decision which accepted the conclusion of the earlier opinions, saying:

> "This dispute concerned the valuation of fixed assets which were alleged to be overvalued such that the relevant warranty as to true and fair was wrong. It was found that certain assets should have been valued at net replacement cost but had been valued at gross replacement cost; in other words, not in accordance with the valuation rules in Part C of Schedule 4, Companies Act 1985. Nevertheless certain assets had been undervalued by at least as much as that overvaluation.

> Accordingly the line item in the audited accounts for Fixed Assets did give a true and fair view."

202. I agree that this provides some further support for the conclusion I have reached above as a matter of first principles.

203. The more substantial attack by the claimants on the Interim Accounts is that certain items were substantially overvalued, and that certain liabilities were wrongly excluded. For that reason, it is said that the Interim Accounts did not enable a reasonable judgment to be formed as to the assets and liabilities of BHUK, and wrongly identified available distributable profits when in reality there were none. The claimants' complaints relate to the following items:

i) The carrying value of investment in SGI (relating to £100,000 of that value, not the £150,000 which was a misdescription). The claimants contend this should have been written down to nil.

ii) The carrying value of investment in TBG, which (including £150,000 to adjust for the misdescription relating to SGI) was £1,283,679. The claimants contend this should have been written down to nil.

iii) The loan from Cestrum, which was included at a value of £1.9 million. The claimants contend that this was wholly irrecoverable.

iv) The loan from K2 Con, which (including the amount recorded as due from TBG) was stated as £2.186 million. The claimants contend that this was wholly irrecoverable.

v) The claimants contend that the Interim Accounts should have included a provision for liabilities under leases (one where BHUK was the tenant, although the premises were occupied by K2 Con, and one where K2 Con was the tenant and BHUK was the guarantor) and under a guarantee of certain subsidiaries' bank debt;

vi) The claimants contend that the Interim Accounts ought to have obtained an accrual for the legal fees of Addleshaw Goddard relating to the demerger;

vii) The claimants also complain at certain small items which the defendants' expert agreed should not have been included. The aggregate amount of these items is £11. These are de minimis, even taking into account the minimal margin for error in the distributable reserves. Accordingly, I need not consider them further.

***Accounting for fixed assets***

204. BHUK accounted for its fixed assets on the historic cost basis. The experts were agreed that generally accepted accounting principles require consideration of whether the carrying value of an asset is recoverable and, if not, an adjustment to be made, citing Financial Reporting Standard 11 ("FRS 11"), applicable to financial statements prepared in accordance with UK GAAP.

205. Under the sub-heading "scope" of FRS 11, FRS is said to apply to all financial statements that are intended to give a true and fair view of a reporting entity's financial position or profit or loss for a period. While there is no specific requirement that interim accounts must give a "true and fair view", I find that – particularly in light of the specific incorporation by reference of provisions for depreciation or diminution in value of assets into s.270(2) – the requirements of FRS 11 are a relevant consideration in determining whether interim accounts enable a reasonable judgment to be made as to the matters in s.270(2).

206. The objective of FRS 11 is to ensure, among other things, that "fixed assets and goodwill are recorded in the financial statements at no more than their recoverable amount", and that "sufficient information is disclosed in the financial statements to enable users to understand the impact of the impairment on the financial position of the reporting entity."

207. In the summary to FRS 11 it is noted that it would be unnecessarily onerous for all fixed assets and goodwill to be tested for impairment every year: "In general, fixed assets and goodwill need be reviewed for impairment only if there is some indication that impairment has incurred". This may be so, for example, if the business in which the fixed asset is involved has suffered a current period operating loss, or there has been a significant adverse change in either the business or market in which the fixed asset is involved, or there is a commitment by management to undertake a significant reorganisation.

208. Impairment is defined as "a reduction in the recoverable amount of a fixed asset or goodwill below its carrying amount." It is measured by comparing the carrying value of the fixed asset (or income-generating unit) with its recoverable amount. The recoverable amount is "the higher of the amounts that can be obtained from selling the fixed asset or income-generating unit (net realisable value) or using the fixed asset or income-generating unit (value in use)." Value in use is calculated "by discounting the expected cash flows arising from the use of the fixed asset or assets in the income-generating unit at the rate of return that the market would expect from an equally risky investment."

### *(i) SGI*

209. The carrying value of the shares in SGI, in the Interim Accounts, was £250,000. It is common ground that, as to £150,000, it is a simple misnomer, because it relates to the cost of BHUK acquiring shares in TBG from a Mr Irwin in 2006.

210. The remaining £100,000 is explained as follows:

    i) SGI was incorporated in 1999. It issued 100 shares: 50 to TBG, 50 to a Mr Irwin.

    ii) On 19 June 2001, TBG acquired Mr Irwin's shares. On the same date, TBG acquired the assets, liabilities and trade of SGI. The consideration for this acquisition by TBG was £100,209, which was left outstanding as an interest free loan by SGI to TBG.

iii) On 27 June 2002, BHUK acquired the entire issued share capital of SGI from TBG. Consideration for this acquisition was £100,000, which was left outstanding as a loan from TBG to BHUK.

iv) At some time between July 2005 and about October 2006, K2 Con acquired the assets and liabilities of TBG. Thereafter, and as at the time of the demerger, the position was therefore as follows: (a) BHUK owned all the shares in SGI; (b) SGI's only asset was a debt of £100k due to it from K2 Con; and (c) BHUK owed K2 Con £100k.

211. Accordingly, from BHUK's perspective, there were equal and opposite entries in its ledgers: (a) an asset of £100,000 (its investment in SGI) and (b) a liability of £100,000 (a debt due to K2 Con). The latter was treated as a debit in the inter-company account between BHUK and K2 Con although overall K2 Con was a net debtor of BHUK.

212. I infer, from the fact that the Interim Accounts were directly derived from the Navision accounting software, that SGI had been accounted for in this way for some years prior to 2007. I have no reason to believe that Tenon were not fully aware of the requirements of FRS 11 as to when it would be appropriate to consider impairment of assets. It is inconceivable that Tenon did not know that SGI had been dissolved in 2003. Yet they were prepared to sign off on BHUK's accounts, on a going concern basis, with a clean audit opinion, for each year up to and including the year ended 30 June 2007 without requiring an impairment to be made in relation to SGI.

213. The circumstance of SGI's dissolution would undoubtedly have been such as to require *consideration* (in 2003) of whether impairment was necessary.

214. Had impairment of SGI been considered, then the question would have been whether the carrying value of £100,000 in SGI could still be justified. The defendants contend that it was justified, on the following basis. So long as SGI could be restored to the register, then it would have been possible to offset the value represented by the investment in it against BHUK's indebtedness in the same amount owed to K2 Con. With SGI restored to the register, then by a series of simultaneous accounting entries: BHUK could satisfy its indebtedness to K2 Con; K2 Con could satisfy its indebtedness to SGI; and the value of BHUK's investment in SGI could be written off. In other words, BHUK's investment in SGI had value of the same amount as the value of BHUK's indebtedness to K2 Con.

215. The claimants accept that something like this could have been done at some time earlier than 2007. They contend, however, that it was not possible in October 2007. First, because there would have been significant expense involved in restoring SGI to the register and, second, because it depended on K2 Con being good for a debt to SGI of £100,000 (which it was not).

216. As to the former, which was based on Mr Davidson's suggestion as to the expense, generally, of restoring companies to the register, I consider that such an application in the case of SGI would have been straightforward, particularly as it would require the filing of dormant company accounts only, and thus relatively inexpensive.

217. As to the latter, there was no cash-flow difficulty with the transaction since it could have been achieved by a series of accounting entries. The only objection therefore was if it would have been impossible for K2 Con, due to its financial position and taking into account the interests of its creditors, to agree to writing off its asset (the debt due from BHUK) in exchange for the writing-off its debt due to SGI. I deal with the solvency position of K2 Con below, but in circumstances where it was in fact continuing to trade and its financial statements for the year ending 30 June 2007 received an unqualified audit opinion in early 2008, I find that it would have been reasonable to conclude, in October 2007, that K2 Con could have done so.

218. Accordingly, I consider that it was reasonable, in October 2007, to regard BHUK's investment in SGI as still having a value of £100,000.

***(ii) TBG***

219. By October 2007, TBG was a dormant company, its assets and liabilities having been sold to K2 Con (at some point between July 2005 and about September 2006, but "as of" 1 July 2005).

220. In its audited financial statements for the year ended 30 June 2007, TBG is recorded as having a single asset, being a debt owed by K2 Con of £900,000, and a single creditor, being a debt owed to Mr Fielding of £450,000.

221. It nevertheless had a carrying value in the books of BHUK of £1,283,679 (£1,133,679 of which was identified in the Interim Accounts as attributable to TBG and £150,000 of which was, as explained above, mistakenly attributed to SGI). Based solely on the net assets of TBG as recorded in its financial statements, this is manifestly an overvaluation of at least £833,679 (on the assumption that the realisable value of TBG's net assets at the time was £450,000).

222. The claimants contend that the debt due from K2 Con was irrecoverable and accordingly the investment in TBG should have been written down to nil. That would have resulted in a realised loss of £1,283,679 which alone would have wiped out the entirety of the distributable profits and thus rendered the Distribution unlawful.

223. I will address the two issues identified by the claimants separately: (i) should the investment in TBG have been written down to nil? (ii) if so, should a realised loss have been recognised in the Interim Accounts?

***Possible justifications for the carrying value of TBG***

224. The defendants offered a number of justifications for TBG's carrying value:

i) The net assets of TBG were at least £900,000 because the loan from Mr Fielding of £450,000 was written off prior to the date of the Distribution and the debt due from K2 Con had a value equal to the face amount of the loan (£900,000);

ii) TBG expected to recover a further sum (in excess of its carrying value) by way of costs from Ultraframe. Although this could not be recognised as an asset in

TBG's accounts (until the costs were actually recovered) it justified there being no impairment to its carrying value;

iii) The carrying value for TBG related to the value of its business which, on the reorganisation effected in 2005-2006, was transferred to K2 Con as of 1 July 2005, but the carrying value of K2 Con was never increased, remaining at a nominal £1,000. Accordingly, this is merely a further case of misdescription.

***Write-off of the directors' loan and the value of the debt due from K2 Con***

225. The contention that the directors' loan of £450,000 had been written off is based primarily on Mr Fielding's ninth witness statement served in February 2019, in which he said "In my Re-re-amended Defence … I explained that the Loan was eventually written off. To the best of my recollection, the Loan was written off in 2007 before the date of the Distribution." The relevant paragraph in the defence (supported by a statement of truth signed by Mr Fielding) pleaded that because the loan did not appear in TBG's financial statements for the year ended 30 June 2008 it "must have been" written off.

226. I find this evidence unconvincing for two reasons. First, the way the point was put in the defence was clearly not based on recollection, but on working backwards from the fact that the loan did not appear in the 2008 accounts. Second, those accounts made no reference to the loan either in the column for 30 June 2008 or in the column for the prior year (2007). That is clearly wrong so far as 2007 is concerned, which calls into question the accuracy of the accounts for 2008. In any event, the latter were not signed until 4 September 2009 so indicate no more than that by that date the loan had been written off.

227. More compelling is the fact that TBG's audited accounts for the year ended 30 June 2007, signed on 23 January 2008, included the £450,000 debt due to Mr Fielding. Had it been written off by 23 January 2008 this would have been recorded as a post-balance sheet event, but there is no such reference.

228. For this reason, and given the absence of any reference to the loan having been written off in any of the papers provided from Tenon's files at any time in 2007, I reject the possibility that the directors' loan account had been written off as at 12 October 2007.

229. I address the question of the recoverability of debts due from K2 Con below at paragraph 293ff. For the reasons there set out I consider it was reasonable to conclude, in October 2008, that the value of the debt due from K2 Con was equal to its face value. This justification alone does not, however, answer the objection that the carrying value of TBG was overstated by more than £830,000.

***Ultraframe costs recovery***

230. The Ultraframe proceedings commenced in November 1998 with an action referred to as the "Leeds Action". At that stage Mr Fielding was the only defendant related to the Burnden Group. In March 2001 further proceedings (the "London Action") were commenced in which the defendants were Mr and Mrs Fielding and TBG. Both of these actions were dismissed at an early stage, through a combination of preliminary

issues and strike out applications, with costs being deferred to the end of the trial in the "Main Action", which commenced in November 2002. The defendants to the Main Action included Mr and Mrs Fielding and TBG. In June 2004, K2 Con and BHUK were added as defendants.

231. Judgment was handed down in favour of the defendants in the Main Action in June 2005. In November 2005 Lewison J awarded the defendants their costs, subject to a series of percentage deductions. He also ordered an interim payment of £2 million, broken down as to £750,000 to Mr and Mrs Fielding and TBG and £1.25 million to the defendants in the Main Action (including therefore both TBG and K2 Con).

232. Ultraframe appealed the costs order. In the course of the hearing before the Court of Appeal, the Burnden parties, through their counsel, conceded that they would not seek to recover from Ultraframe any costs of advancing a dishonest case. The Court of Appeal reduced the amount of the interim payment to £1.84 million. This was paid in January 2007 and was accounted for as a receipt by K2 Con.

233. On 21 January 2008 a consent order was signed in the Ultraframe proceedings, under which Ultraframe agreed to pay £1,587,500 to K2 Con (and £125,000 to a Mr Clayton, another defendant in the proceedings) in full and final settlement of all costs liability.

234. Ultimately, although Ultraframe agreed to pay K2 Con over £1.5 million, only £602,000, net of legal costs, was received by it. A large part of the difference was retained by Addleshaw Goddard in respect of their fees relating to the costs of recovery. In addition, Mr Joyce explained at trial, Addleshaw Goddard also received about £400,000 by way of "success fee" out of the Ultraframe costs recovery in February 2008. He said that he had reached a "gentleman's agreement" with Mr Fielding at some point in 2007, though he could not remember if it was before or after the Distribution, that Addleshaw Goddard would be entitled to a success fee out of the Ultraframe costs recoveries, and that he reached a firm agreement on the amount once the settlement figure had been agreed with Ultraframe. Mr Fielding agreed that at some point in January 2008 he agreed to a bonus payment of £400,000. Although this explanation arose for the first time during the oral evidence, I accept that there was some arrangement to this effect, given that it is common ground that Addleshaw Goddard were paid in the region of half a million pounds from the costs recovery, and that Mr Joyce (whom as I have noted above I found to be an honest and straightforward witness) would have no reason to lie about this.

235. The financial statements for the companies reveal that (1) between 2003 and 2004 TBG expended £2,124,379 and (2) between 2004 and 2005 K2 Con expended £4,132,453 on the Ultraframe proceedings. The defendants also claim that a further £1.7 million was charged to TBG's operating profit in 2001 and 2002 (representing sums paid by TBG and by Mr and Mrs Fielding which they recharged to TBG). The total amount said to be recorded in the companies' financial statements is accordingly £7.96 million.

236. Addleshaw Goddard's billing system indicates that a total of £7,263,342 (including VAT and disbursements) was charged to the Burnden parties. In addition, Halliwell Landau (instructed by TBG in the period 2001 to 2004) invoiced a further £1,047,753.22 to TBG. The total sum invoiced was therefore £8.31 million.

237. The claimants contend, however, that the full amount expended by the Burnden parties on the costs of the Ultraframe litigation was only £6.8 million. That is the sum identified by Mr Joyce as the total amount expended by them (including in relation to the costs incurred in the Court of Appeal) in a document sent to Ultraframe's solicitors, Eversheds, on 30 November 2007. That in turn was based on an internal memo from Brian Dinnewell (Addleshaw Goddard's costs draftsman) dated 29 November 2008, in which Mr Dinnewell identified £6.8 million as the full amount billed to the Burnden defendants, adjusted to reflect VAT advice received from Tenon (no VAT was recoverable on invoices addressed to TBG and only 28% of VAT was recoverable on invoices addressed to K2 Con).

238. In the document sent to Eversheds, Mr Joyce set out the percentage deductions, in accordance with Lewison J's order. In his witness statement, Mr Joyce said that amounts relating to the dishonest defence, following the concession made to the Court of Appeal, were also deducted from the bills of costs. He then deducted the amount of the interim payment. The balance remaining after all those deductions was £3.34 million. To that he added interest, estimated at £1.2 million, arriving at a total amount of £4.54 million. In his covering email he said, without prejudice, "I have discussed with our client what the figure is that he is looking for and the figure is £3m".

239. In his evidence at trial, Mr Joyce described the document sent to Eversheds on 30 November 2007 as "the most accurate and most inclusive document that exists" in relation to the costs recoverable from Ultraframe. He said that it included all the work they had done on everything, having taken all discounts off it that had been ordered.

240. I accept that this document, being a contemporaneous record of the amount which the Burnden parties were prepared to share with Ultraframe in an attempt to reach settlement, is the best evidence of the maximum amount that could be claimed on an assessment of costs. While it may well be the case that higher sums had been billed by Addleshaw Goddard over the years, the additional amounts (for example, at least some of the VAT billed) were regarded as irrecoverable.

241. That maximum amount recoverable of £4.54 million would, however, have inevitably been reduced on an assessment of costs. It was no doubt in recognition of that fact that Mr Joyce, on instructions from his clients, offered to accept £3 million in full and final settlement of all costs liability. In the notes of the audit exit meeting of 18 October 2007 it was noted with regard to the "Court case" that it was "expected to net £2m after legal costs in Feb 2008". Notwithstanding this, the gross amount of £3 million was included in the cashflow forecast for K2 Con within the management accounts prepared in December 2007 in respect of anticipated recovery from Ultraframe, in March 2008 (although it is not clear whether the associated costs were included elsewhere in the forecasts).

242. Doubts were expressed, for example at the board meeting for BHUK on 29 August 2007, as to the recoverability of any sum awarded by way of costs against Ultraframe. The minutes of the meeting record that it was noted that "Ultraframe's ability and willingness to pay without protracted negotiations was however very uncertain". Mr Joyce had expressed concerns over Ultraframe's ability to pay, in a witness statement he made in 2006 in the context of applications for security for costs. In the witness box he explained that while at an earlier stage there had been concerns over Ultraframe's ability to pay, those had receded by 2007, following the acquisition of

Ultraframe by a Mr Brian Kennedy. Mr Fielding gave evidence to the same effect. I note that the comment in the minutes of 29 August 2007 was directed more at Ultraframe's willingness to pay, combined as it was with the phrase "without protracted negotiations". This is supported by the notes of the audit exit meeting on 18 October 2007 which stated, in respect of the anticipated costs recovery, "hopeful of receiving as no longer think Ultraframe can walk away."

243. The defendants contend that at the time of the Distribution TBG retained a substantial entitlement to costs against Ultraframe, such that it remained possible that the anticipated costs recovery could have been allocated to TBG. As I have noted above, TBG had itself incurred costs in the region of £3.84 million.

244. The defendants' original case was that none of TBG's entitlement to costs had been transferred to K2 Con under the transfer of TBG's assets and liabilities as of 1 July 2005. As a result of disclosure provided by Tenon on 27 December 2018, however, the defendants had cause to reconsider their position. They now contend that £2 million of TBG's costs entitlement was transferred to K2 Con, leaving a sum in the region of £1.84 million of the costs entitlement (the precise sum depends upon whether VAT is included; without VAT the sum is £1.74 million) in the hands of TBG. The circumstances surrounding the transfer from TBG to K2 Con are far from clear. The defendants point to the fact that the "Assets" transferred under the sale and purchase agreement does not include any amount of TBG's cost entitlement. They contend that the position as to costs entitlement was deliberately not dealt with in the agreement so as to leave it vague.

245. There are two problems with this argument. First, it is difficult to see any commercial sense in leaving any entitlement in TBG to recover costs, since as from 1 July 2005 it was a shell company with no business. K2 Con, on the other hand, was a substantial trading concern, with an ongoing need for cash.

246. More importantly, the contemporaneous documents in the months leading up to, and immediately after, the Distribution make it clear in my judgment that the whole of the anticipated costs recovery was to be accrued in K2 Con. I have already referred above to the fact that by November 2007 the anticipated costs recovery was no more than £3 million (before deduction for the costs of assessment). In the pre year end meeting with Tenon Audit on 18 May 2007, item 3 states: "Legal Case – it is likely to go to a cost hearing – expecting £3.6m". In the minutes of the BHUK board meeting of 1 June 2007, it is noted in the context of a discussion about K2 Con's "technical" breach of the Insolvency Act that "this would become positive if the company recognised the likely outcome of the legal action i.e. receipt of circa £3.6 million in its financial statements."

247. The defendants sought to argue that the reference in the minutes was referring only to that part of the costs recovery that would be allocated to K2 Con, the implication being that there was a further sum in the region of £1.4 million that would be allocated to TBG. I accept that the minutes were referring only to costs to be recovered by K2 Con, but find that that was because: (1) the anticipated costs recovery was £3.6 million and that (2) the whole of the anticipated costs recovery was to be accrued in K2 Con. The fact that item 3 in the note of the meeting with Tenon Audit refers to the same number under the generic heading "Legal Case" supports that conclusion.

248. Further corroboration is to be found in exchanges between Mr Beckett and Tenon shortly after the date of the Distribution. On 14 November 2007 Mr Beckett emailed Mr Duffy of Tenon proposing that the draft version of the statutory accounts "shows a £3 million receipt against legal cost award, the final number to be determined after the trial in February". Mr Duffy responded that they could recognise the £3m receipt in the draft accounts "but obviously would not be able to sign off on these accounts or commit to anyone that they will not change until we see evidence of receipt of monies in due course." It is clear, from an email of 23 November 2007 from Ms Sutcliffe of Tenon Audit to Mr Beckett and Mr Martin, that the draft accounts in which this change was to be made were those for K2 Con. Ms Sutcliffe referred expressly to "recognising the £3m legal income in K2 Cons", and "writing down the goodwill in K2 Cons related to [TBG] to £nil (due to the expected income to which this relates now being received)". This is consistent with the management accounts prepared in December 2007, which provided for the receipt by K2 Con of the full £3 million anticipated costs recover in March 2008.

249. The defendants rely on the notes of the meeting Mr Beckett had with Tenon on 24 August 2007, in which it was noted, under the heading "Investments" that the balance in TBG "should be written down when all legal income is received" and that the "same applies to £2.2m goodwill in K2 Cons". This, they contend, demonstrates that at least part of the costs recovery would be received by TBG. Whatever was meant by this note, I do not think it meant that Tenon understood that any part of the outstanding costs recovery was due to TBG. That is because it is inconsistent with the contemporaneous documents to which I have referred, including those in which the costs recovery was fully accrued in K2 Con's draft accounts. Moreover, if the note had the meaning for which the defendants contend, then it would be expected that the investment in TBG would be written down following receipt of the costs in February 2008, but that did not happen.

250. Taking account of the evidence as a whole, I make the following findings in relation to the Ultraframe costs:

    i) Mr Fielding, along with the other directors of BHUK, honestly believed at the time of the Distribution, that the further costs recovery against Ultraframe was likely to be in the region of £3 million (before deduction of costs of recovery); but

    ii) It was understood by him (and them) at the time that the full amount to be recovered would be accrued in K2 Con.

251. I conclude, therefore, that it was not part of the directors', or Tenon's, thinking at the time that the carrying value in TBG was justified by reason of further anticipated costs recovery by it. Moreover, it is not possible to justify, with hindsight, the carrying value on that basis.

***Mis-description***

252. K2 Con's financial statements for the year ended 30 June 2006 disclose that it acquired the trade and net assets of TBG on 1 July 2005. Whatever value resided in TBG's shares as at that point was reflected in the trade and net assets that were transferred to K2 Con. Accordingly, the defendants are clearly correct to say that the

fact that TBG became dormant as of 1 July 2005 would not have resulted in the loss (from BHUK's perspective) of TBG's value. Rather, it resulted in that value being transferred from one entity to another. The defendants are similarly correct in saying that there was no adjustment made to the carrying value of K2 Con to reflect that transfer. BHUK's shares in K2 Con continued to be carried at the nominal sum of £1,000.

253. The claimants nevertheless contend that, even assuming TBG's financial position was such that, on 1 July 2005, a positive carrying value was transferred to K2 Con, by October 2007 any such value had dissipated, such that the value of K2 Con should have been written down to nil. The basis for that was explained by Mr Davidson in an appendix to his first report: K2 Con was heavily insolvent (having net liabilities in the region of over £2 million even if the defendants' contention that the Ultraframe Costs recovery was anticipated as being in the region of £3.6 million is correct and that sum was added to the balance sheet); it had current assets of £5.7 million to cover current liabilities of £12.5 million; of its current assets, £2.67 million represented debtors, but it had borrowed £3.1 million via invoice discounting; it made substantial losses in 2007; it had suffered a 24% decrease in turnover since 2004; in short, it was very close to being in a position where it would be unable to meet its debts or continue to trade.

254. Neither Mr Davidson nor Ms Barker, however, carried out the task of valuing the recoverable amount of BHUK's investment in K2 Con, as would have been required on an impairment review in accordance with FSR 11. Ms Barker, in her second report, said that she did not consider this an appropriate exercise to undertake because she and Mr Davidson were in possession of significantly less financial information and insight about the company than was contemporaneously available to the directors and Tenon at the time.

255. As noted above, the recoverable amount is the higher of net realisable value or value in use, each of which is based to a large extent on cash-flow projections and future performance of the company. There is some, albeit limited, evidence of what was available to the directors and Tenon at the time. There is no analysis of this, however, in Mr Davidson's reports.

256. Such evidence as is still available includes that identified in the following paragraphs.

257. On 18 August 2006, Mr Moss (the responsible individual), Mr Duffy (audit manager) and Ms Sutcliffe (audit senior) of Tenon Audit met with Mr Beckett to discuss key risks in relation to the audit for the year ended 30 June 2006. These included inter-company debtors (where the need for impairment was discussed in relation to £1m owed by one of the UK subsidiary companies, Canterbury Conservatories UK, and in relation to a £2 million debt due from a US subsidiary, Canterbury Conservatories Inc) and carrying value of goodwill (under which heading each company was considered separately and in which respect it was noted that the goodwill in relation to TBG was still valid, but had been transferred to K2 Cons).

258. It was identified in the 2006 Audit Report that an impairment review would be required in relation to the goodwill in Vital, TBG, K2 Glass, K2 Window & Door and Cestrum.

259. In about February 2007 the directors of BHUK, with the involvement of Tenon, undertook an impairment review into its investments in subsidiaries. On 12 February 2007 Mr Beckett sent to Mr Moss of Tenon "best case" forecasts for each of K2 Con, K2 Glass and Cestrum. Mr Moss responded, saying that he would put the figures through an "impairment model" created the previous year.

260. An "Impairment Review Paper" was included among the disclosure provided by Tenon shortly before trial. The paper is undated but appears, from related documents, to have been prepared in about February 2007. It is based on the requirements of FRS 11. It appears to have been prepared by the directors, but it is clear that Tenon was aware of it, and approved of it, at the time: not only is it a document that was among those disclosed by Tenon, but the directors' audit confirmation letter of 15 March 2007 contained the following: "we consider the impairment review paper prepared by the Board to be accurate and reasonable in terms of both the assumptions and data used and the conclusions reached." I infer from the fact that Tenon gave clean audit opinions in 2006 and 2007 that they saw no reason to dispute this confirmation.

261. The paper noted as follows:

i) The 2006 Tenon Audit Report on BHUK had identified indicators of impairment in respect of each of K2 Con, K2 Glass and Cestrum, and that FRS 11 therefore required a full impairment review, to cover the goodwill in individual companies and the consolidated goodwill attributed to subsidiaries. In the case of K2 Con, Tenon had noted on 23 August 2006 that this was triggered by "persistent operating losses or negative cashflows from operations."

ii) The assets under review in this case were the goodwill attached to the businesses. As net realisable value was not available, the review went straight to the calculation of value in use, which involved four stages: identifying the income-generating unit; estimating expected future cash flows; determining the appropriate discount rate; and discounting expected cash flows to arrive at value in use.

iii) The paper went through these stages for the relevant assets, noting that the expected future cash flows "have been based on reasonable and supportable assumptions. The cash flows are consistent with the most up-to-date budgets and plans that have been formally approved by management."

iv) Appendix 1 to the paper contained the impairment calculation for certain companies, including K2 Con. On the basis of estimated future cash flows of £1.155 million for the next, and each following, year, it identified the recoverable amount for K2 Con as £14.975 million.

v) Paragraph 14 of the paper concluded that no impairment of goodwill was required, whether of the goodwill in individual entities or in the consolidated accounts of BHUK, based on the forecasts and the assumptions set out in the paper.

262. Mr Davidson downplayed the significance of this impairment review, on the basis that it was considering whether the value of the goodwill attributed to the entities should

be impaired. Whatever the object of the review, however, it was in fact undertaken by comparing the carrying value of the entity (in the case of K2 Con, £1,000) with its value in use. Accordingly, to the extent that it offers any guide as to value, it is as to the recoverable amount for the investment by BHUK in the entity.

263. Mr Parker QC made much of the fact that in carrying out the impairment review, the analysis ignored net realisable value, and went straight to value in use. Since, however, recoverable amount is equal to whichever is the higher of the two, even if a valuation had been conducted on both bases, the resulting recoverable amount cannot have been any lower than the figure identified as value in use.

264. While Mr Davidson made no mention in his reports of the impairment review in fact carried out in relation to any of the companies (save for criticising the 8% discount rate used in relation to K2 Glass), and did not undertake his own analysis of K2 Con's value in use or realisable value, in cross-examination he said that given K2 Con's insolvent position in 2007, he could not see it generating £1.155 million per year without a significant injection of working capital. He also reiterated his view that the discount rate of 8% did not properly represent the risk of the business making the anticipated future cash flows. He acknowledged that each of the inputs into the impairment model required a judgment to be made based on the information that would have been available at the time. Overall, he said he had reservations about the numbers used, and that while he accepted that "the process has been followed here, but what has gone into the numbers may not necessarily reflect the reality of that company's financial requirements".

265. The detailed forecasts which indicate how the cash flows of £1.155 million were arrived at are not in evidence. However, what are described as "best case forecasts" produced in February 2007 were sent by Mr Beckett to Tenon on 12 February 2007. These were for the period January 2007 to March 2008. In relation to K2 Con they forecast a net operating loss before interest and tax of £13,000 for the full 15 months. This period included, however, two winters (which are by far the worst months for a conservatory business) whereas, for the 12-month period (which included only one winter) they forecast a profit of £831,000.

266. In a further recently disclosed Tenon document, undated but also appearing to date from about February 2007, prepared in connection with Tenon's consideration of whether it was appropriate for the accounts of BHUK (and its subsidiaries) to be prepared on a going concern basis, these forecasts were noted. The document stated "the forecasts for the period to March 2008 show the group achieving profit overall. The actual results in Jan 07 support the assertion that the forecasts are reasonable."

267. By the middle of 2007, K2 Con had underperformed in comparison with forecasts prepared at the beginning of the year. I refer to the notes of meetings during May and June 2007 set out in section E2 above. In summary, with specific reference to K2 Con, it had failed to meet worst-case forecasts, re-forecasts for April to June were significantly worse partly to reflect the "lower confidence in the recovery of sales in K2", it was balance sheet insolvent, had been accused by HMRC of trading while insolvent and taken insolvency advice from Tenon. On the other hand, that same insolvency advice had indicated that it would be solvent with the anticipated recoveries from the Ultraframe litigation, and that its recovery plan, including

amalgamation of the conservatory businesses resulting in substantial costs savings, appeared "robust".

268. None of the monthly management accounts and other papers that were routinely provided to the board of BHUK are available, except for those prepared in about December 2007. By the time of the Distribution, however, it is apparent that K2 Con's performance had improved to some extent. Tenon's notes of the audit exit meeting of 18 October 2007 recorded that "K2 Cons is performing better than budget". Moreover, by this time Cestrum was anticipating entering into a lucrative contract with B&Q which was expected to generate additional turnover of £35 million annually. This would have benefitted K2 Cons, both because of the boost to inter-company trading and because (as also indicated in the notes of the audit exit meeting) Cestrum was to be amalgamated into K2 Cons, further saving £1 million in overheads.

269. The management accounts prepared in about December 2007 included forecasts for K2 Con, which indicated:

    i) Intra-group sales were anticipated to increase from the beginning of 2008, reflecting the B&Q contract which, together with increasing third-party sales was anticipated to generate operating profits from the spring of 2008;

    ii) The cash flow statement indicated an improvement in the cash position from (-£349,000) in June 2007 to £1,309,000 in June 2008.

270. On the other hand, these forecasts indicated that:

    i) In the full year to June 2008 K2 Con would make an operating loss of £486,000 and a net loss (pre-tax) of £1.183 million;

    ii) Its net liabilities of £1.927m as at the year ending 30 June 2007 would increase to net liabilities of £2.755m by June 2008;

    iii) The improvement in its cash over the period was due to the anticipated receipt of £3m in respect of Ultraframe costs in March 2008 (albeit that by this time the recovery net of costs was anticipated to be £2 million).

271. Tenon undertook a going concern review for the purposes of the audit of the financial statements for the year ended 30 June 2007. In a document dated 30 November 2007, Tenon identified as indicators relevant to the going concern analysis: major losses or cash outflows since the balance sheet date; an excess of liabilities over assets; net current liabilities; and dependence on intra-group borrowings. At that stage, Tenon concluded its review only in relation to K2 Glass, but it conducted a detailed review of K2 Con (and Cestrum) in February 2008. At that point, having regard to detailed forecasts (which are no longer available, but which Tenon stated were based on reasonable assumptions) Tenon's conclusion was that based on the evidence obtained there was not a significant level of concern about the company's ability to continue as a going concern. This was the subject of a second line of review within Tenon, with the same conclusion.

272. Drawing together these points, I conclude as follows. First, looking only at K2 Con's net assets, a carrying value of £1.284 million (being the combined carrying values of K2 Con and TBG) could not be justified. Second, any positive carrying value therefore had to be justified on the basis of future projected performance, so as to identify its recoverable amount (either value in use or realisable value) at the time of the Distribution. Neither expert has attempted to do so. Third, I regard the recoverable amount indicated by the impairment review in February 2007 as unrealistically optimistic. Even if the value in use ascribed to it in the impairment review of February 2007 was reasonable as at that date, it had ceased to be reasonable by October 2007, in light of the fact that over the ensuing months it had performed significantly worse than the forecasts used for the purposes of the impairment review, and that in December 2007 it was forecast to make a loss in the full year to 30 June 2008. Fourth, I nevertheless consider that, in view of the fact that such contemporaneous materials as have survived provide a reasonable basis for believing that K2 Con would return to profitability within a few months, it would have been appropriate to ascribe at least some value to the recoverable amount in respect of BHUK's investment in K2 Con. Fifth, in the absence of either expert having addressed this question on the correct basis (i.e. by reference to its value in use or realisable value at the time), it is impossible to reach a firm conclusion as to what the proper recoverable amount would have been. Sixth, on this issue it is the defendants who bear the burden of proving that K2 Con's value was at least £833,000 (being the difference between TBG's net assets and the value ascribed to it in the Interim Accounts). That is because it is their case that the carrying value of K2 Con is to be included as part of the value ascribed to TBG in the Interim Accounts. In circumstances where the defendants have failed to adduce any expert evidence as to the value of K2 Con as at the date of the Distribution, I conclude that they have failed to discharge that burden.

***Realised loss***

273. The second question is, even though BHUK's investment in TBG had a value less than that identified in the Interim Accounts, whether it follows that those accounts should have recognised a realisable loss equal to that reduction in value. The defendants contend that there was no such requirement, in accordance with established accounting principles, to impair the carrying value of TBG in its accounts.

274. The argument is based on s.275 of the 1985 Act, which (in the version in force at the relevant time) provided as follows:

> "(1) For the purposes of sections 263 and 264, the following are treated as realised losses – (a) in the case Companies Act individual accounts, provisions of any kind mentioned in paragraphs 88 and 89 of Schedule 4 (other than revaluation provisions)…
>
> (1A) In subsection (1), a revaluation provision means a provision in respect of a diminution in value of a fixed asset appearing on a revaluation of all the fixed assets of the company, or of all of its fixed assets other than goodwill.
>
> …

> (4) Subject to subsection (6), any consideration by the directors of the value at a particular time of a fixed asset is treated as a revaluation of the asset for the purposes of determining whether any such revaluation of the company's fixed asset is required for the purposes of the exception from subsection (1) has taken place at that time."
>
> (5) But where any such assets which have not actually been revalued are treated as revalued for those purpose under subsection (4), that exception applies only if the directors are satisfied that their aggregate value at the time in question is not less than the aggregate amount at which they are for the time being stated in the company's accounts."

275. As at 12 October 2007 BHUK's fixed assets consisted almost entirely of investments in subsidiary companies (the only other asset being a de minimis amount attributed to patents). These were carried in its books at historic cost. It is not suggested that there was any actual revaluation of BHUK's fixed assets (other than Vital) in October 2007. Instead it is contended that if there had been, then such an exercise would have demonstrated that the aggregate value of all of BHUK's fixed assets, even if TBG was written down to nil, was not less than the aggregate amount at which they were stated in its books. There would accordingly have been no need to treat the diminution in value of TBG as a realised loss.

276. The claimants object to the point being raised, given that it was not pleaded, it was referred to only in passing in opening and not properly developed until closing argument, and that it is not supported by any factual, expert or documentary evidence. In particular, they contend that there is no evidence of a revaluation having occurred of all of BHUK's assets, of which the directors were aware and on the basis of which the directors satisfied themselves that the aggregate value of BHUK's fixed assets was not less than that recorded in the balance sheet.

277. The defendants contend that there was no need to plead the point, since it is a pure point of law, and raises no issue of fact. It is a hypothetical argument, say the defendants, which arises in circumstances where (1) investments in subsidiaries were included in BHUK's accounts at historic cost; and (2) the claimants allege that consideration should have been given to impairment in relation to one or more of the investments in subsidiaries and, if that had been done, they should have been impaired because their recoverable amount was less than the carrying value. It being common ground that no impairment review was in fact carried out in the course of preparing the Interim Accounts, the defendants' argument is that *had it been*, then there would have been no need to record the difference between the recoverable amount and the carrying value of the shares in TBG as a realised loss, because in aggregate the recoverable value of all fixed assets was greater than their aggregate carrying value.

278. While I agree with the defendants that, because the point is a hypothetical one, most of the objections made by the claimants are therefore misplaced (it being irrelevant, for example, that there is no evidence that the directors actually carried out an impairment review of all of BHUK's fixed assets), the argument does depend upon one crucial question of fact: namely whether the aggregate recoverable amount of all the fixed assets was at least equal to their aggregate carrying value. However, it is

common ground that (1) the recoverable amount in respect of K2 Glass was at least its carrying value (£2,534,736) and (2) the recoverable amount in respect of BHUK's investment in Vital was at least £3.7 million (this is the lowest point in the range for the market valuation of Vital according to Ms Barker). Together, these are undoubtedly greater than the carrying value of all of BHUK's fixed assets (£4.69 million, as per the 2007 audited financial statements). In fact, I conclude (in section E12 below) that Vital's value was £15m. That alone comfortably exceeded the carrying value of all the fixed assets listed in the Interim Accounts. It is permissible, in my view, to take account of the value of Vital, notwithstanding that the purpose of the Interim Accounts was to justify its disposal via the Distribution, because the focus under s.275 is solely on the amount of distributable profits *prior to* the Distribution.

279. In my judgment, therefore, to the extent that the argument depends upon an issue of fact, it is one that was clearly established on the evidence. It is otherwise a pure point of law, and no prejudice has been caused to the claimants in permitting the defendants to run the argument.

280. Aside from their objections noted above, the claimants did not have an answer to the substance of the argument. Accordingly, I conclude that even though the carrying value of TBG was overstated, this did not require a realisable loss to be recorded in the Interim Accounts, and so did not have an impact on the distributable profits revealed by them. I add that if this is wrong as a matter of law, then the for reasons similar to those in 272 above, the defendants have not established that K2 Con's value was sufficient to avoid the loss arising on the write-down in TBG's carrying value resulting in there being insufficient distributable profits to enable the Distribution to be made.

### *(iii) Debt due from Cestrum*

281. At the date of the Interim Accounts Cestrum owed BHUK £1.9 million.

282. Mr Davidson's opinion is that this debt had no value and should have been fully impaired. His opinion is based on his view that Cestrum had net liabilities, as at the time of the Distribution, of £441,684. He arrived at this sum by adjusting the balance sheet disclosed in Cestrum's financial statements for the year ended 30 June 2007 (net liabilities of £978,483) in two ways. First, by adding back £961,472, to account for the fact that the value of the building owned by Cestrum was significantly greater than the amount included in the financial statements (although I note that he used the amount actually realised on the sale of the Cestrum building, not the slightly greater amount anticipated as being received in October 2007). Second, by reducing the figure for goodwill from £424,673 to nil, on the basis that Cestrum appeared not to be growing, suffered a marked reduction in profit margin in 2007 and appeared to have increased costs, all of which contributed to an operating loss in 2007.

283. The first thing to note is that, even if it was correct, in determining the value of the debt owed by Cestrum, to have regard only to the value of its net assets at the time of the Distribution, only a partial impairment would have been justified, given that its tangible assets were valued at approximately 86% of its total indebtedness.

284. More importantly, I consider that it is wrong simply to have regard to Cestrum's net asset position at the date of the Distribution. Mr Parker QC submitted that it was

necessary to look only to the net assets of the debtor as at the date of the Distribution because it was necessary to ask whether the subsidiary could pay the loan on that date. He prays in aid the fact that in considering the solvency of a company only its present assets are to be included (as held in *Byblos Bank SAL v Khudhairy* [1987] BCLC 232, at p.247e-g, per Nicholls LJ), and submits that it follows that no account can be taken of the future value of present assets.

285. In my judgment, however, this fails to distinguish between the existence, on the one hand, and the value, on the other, of a company's assets. The value to BHUK of the debt owed by its subsidiary (an existing asset at the relevant date) is to be measured, not by taking a snapshot of the subsidiary's net assets on the date of the valuation, but by assessing the commercial likelihood of the debt being repaid. This involves a judgment based on a number of factors, including whether BHUK's circumstances are such that it requires payment of the debt immediately, or is in a position to afford the debtor time to pay, and whether the debtor's trading prospects are such that if given time it could pay in full.

286. To take an extreme example, if the debt is due in a year's time and the debtor currently has net liabilities, but its trading prospects are such that in a year's time it is likely to be able to pay the debt in full, then from the creditor's perspective there would be no reason not to value the debt at its face value, subject only to a possible discount for the time value of money. Even in the case of an immediately due and payable debt, it may be that while the debtor has positive net assets, it needs to realise a particularly large illiquid asset before it can pay. Its inability to pay the debt immediately does not mean that the debt, in the hands of the creditor, is worthless. The prospect of future payment is part and parcel of the present value of the debt, from the creditor's perspective, similar to the way that the future trading prospects of an entity are embedded in the present value of that entity from the perspective of the entity's owner.

287. This does not contravene the principles derived from *Byblos Bank*; there is no question of taking into account future assets of BHUK; it is merely that in valuing the present assets of BHUK, where those assets consist of receivables, it is permissible to have regard to the future prospects of the debtor in considering whether the debt is recoverable.

288. In the case of BHUK, given that it was under no pressure to pay its own debts from its creditors (being principally the Fieldings and subsidiary entities) it could afford to take a long-term view as to the recoverability of the debt from Cestrum. Accordingly, it is necessary to enquire into Cestrum's future trading prospects, in seeking to place a value on the debt as at October 2007. Mr Davidson has not undertaken that analysis. I have noted in section D above the fact that much of the documentation available to the directors and Tenon at the time is now unavailable. The absence of much of that material, including the monthly accounts packages, makes this task more difficult. But such evidence as has remained reveals the following:

    i) Along with the rest of the group, Cestrum was facing a serious cash crisis, which the Distribution was intended to alleviate;

ii) In the meeting with Tenon Audit in May 2007 it was noted that Cestrum was likely to become "very cash generative", as a result of a beneficial relationship with Apple Panels;

iii) The recovery plan discussed at the board meeting of BHUK on 1 June 2007 referred to a planned amalgamation of Cestrum into the site occupied by K2 Con, which was anticipated to save £1 million in overheads;

iv) By the time of the Distribution, the directors anticipated that Cestrum would enter into a lucrative contract with B&Q, generating additional turnover of £35 million per year.

v) This was reflected in the cashflow forecast contained within the management accounts prepared in December 2007, which anticipated third party sales increasing to over £3 million by March 2008 and over £3.5 million by June 2008. In contrast, the best case cashflow forecast from around February 2007 anticipated third party sales reaching just over £1 million by March 2008;

vi) Those forecasts also showed that Cestrum was expected to generate a positive net cash flow of £3.159 million in the year ended 30 June 2008 and that, while the forecast did not envisage any part of the intra-group lending being repaid in the period, that intra-group lending was more than matched by available cash by the year end;

vii) Although these management accounts post-date the date of the Distribution, they are the only detailed management accounts that have survived. In the absence of equivalent management accounts from earlier in the year, and taking account of the fact that the major factor influencing the turnaround in Cestrum's fortunes was the B&Q contract, which was anticipated as at the time of the Distribution, I infer that a similarly positive picture would have been presented in those earlier accounts;

viii) Tenon, with much greater information available to it than is now available, was prepared to sign a going concern audit opinion in both 2006 and 2007.

289. The claimants rely on the fact that Cestrum, like the rest of the group, had a severe cash-flow crisis. They contend that Cestrum was or was likely to become cash-flow insolvent and that, without a significant injection of cash, it would be forced to cease trading within months. That was undoubtedly true, but then it was the Distribution, and subsequent injection of cash by the Fieldings, that was the intended solution to the group-wide cashflow problem. The claimants rely on *Bucci v Carman* [2014] BCC 269 for the proposition that an insolvent company does not cease to be insolvent by borrowing sufficient funds to meet its debts in the near future (see Lewison LJ at [31]). I accept that a company that is *balance sheet* insolvent does not cease to be balance sheet insolvent merely by borrowing more money, although by doing so it may be able to avoid cash-flow insolvency. Accordingly, if the relevant question was whether Cestrum was insolvent at the time of the Distribution, the claimants would have an unanswerable case. However, that is not the question: for the reasons I have already set out above, the valuation of the debt owed by Cestrum to BHUK is dependent on a range of factors, of which Cestrum's current solvency position at the time of the valuation is just one.

290. The claimants point out that in the forecasts contained within the management accounts from December 2007 it was envisaged that the profit arising on the sale of the Cestrum building would be matched by the trading losses incurred in the meantime. In my judgment, that does not detract from the conclusion that Cestrum would within a reasonable time have sufficient cash to repay the debt. The anticipation that the debt could be repaid in the future was not based on the receipts from the Cestrum building, but those receipts were to be utilised in facilitating trading until the expected benefits of the B&Q contract could be realised.

291. Ultimately, as noted in *Paycheck* (above at paragraph 189) it is necessary to ask whether, based on what was known at the time, the inclusion of the debt due from Cestrum at its face value was "the making of a reasonable judgment based on facts as reasonably perceived."

292. Recognising that the information now available, as to Cestrum's future performance prospects, is incomplete, I conclude that it was reasonable, at the time, to include in the Interim Accounts the debt due from Cestrum at face value. While the views of Tenon, as indicated by what they did at the time, are far from determinative, I nevertheless regard the facts that (a) Tenon (with much more information available to them) expressly considered the issue of impairment of receivables when auditing BHUK, (b) made no impairment save in respect of the Canterbury UK and a US subsidiary, and (c) signed off on the accounts of all of the companies on a going concern basis, as important evidence in support of my conclusion.

***(iv) Debt due from K2 Con***

293. At the date of the Interim Accounts, K2 Con owed BHUK £2.186 million (including the debt previously due from TBG which K2 Con had acquired on the transfer of TBG's assets and liabilities to it). It also owed £900,000 to TBG.

294. Mr Davidson's view is that the amounts owed by K2 Con should have been written down to nil, given that K2 Con was heavily insolvent (as I have described in paragraph 253 above when considering the value of BHUK's investment in K2 Con).

295. I accept that if K2 Con had been required to repay the full amount of the loans on the date of the Distribution then it would have been unable to do so, and the value of the loans would need to have been substantially impaired. As I have already noted when considering the debt due from Cestrum, however, BHUK's long-term support from its lenders (the Fieldings) meant that it could take a long-term view as to the recoverability of debts due from its subsidiaries. Accordingly, in considering the value of the loan from K2 Con it is necessary to consider K2 Con's future prospects as at the date of the Distribution. Again, as with Cestrum, Mr Davidson has not undertaken that analysis and much of the information available to the directors at the time is no longer available.

296. The defendants contend that the management accounts produced in December 2007 demonstrated an intention on the part of the Group to repay K2 Con's debt to BHUK in the first quarter of 2008. They point to the fact that the cashflow forecasts anticipated a reduction in K2 Con's indebtedness of £4.598 million (taking into account both the line item "Inter Company Trading A/C" and the line item "Loans Inter Group) from £7.602 million in February 2008 to £3.004 million in March 2008,

and (as explained by Mr Beckett in evidence) to the fact that in the Group consolidated cashflow forecasts there was a similar reduction in the overall lending from the Fieldings at the same time.

297. I reject this contention. The whole of the repayment in K2 Con's inter-company debt envisaged in March 2008 would simply have reduced the overall indebtedness of K2 Con to the level it was as at the time of the Distribution. As at the end of September 2007, K2 Con's intra-Group indebtedness stood at £3,032 million. In October 2007 this increased to £5.689 million, reflecting the loan made by Mrs Fielding using the proceeds of the sale of part of her interest in Vital. Over the course of the next few months, the indebtedness increased to a peak of £7.602 million in February 2008 (although, as Mr Beckett pointed out, there was anticipated to be a substantial cash balance during the period November 2007 to February 2008, and the Group could have chosen to use this cash balance rather than drawing down any further on loans from the Fieldings). In March 2008, the balance of K2 Con's intra-Group indebtedness was envisaged to reduce to £3,506 million. In other words, the repayment anticipated in March 2008 would have repaid only the additional borrowing incurred since October 2007.

298. Moreover, in Note 28 to K2 Con's financial statements for the year ended 30 June 2007 it was stated that its ability to continue as a going concern was reliant upon continued provision of loans from fellow subsidiary undertakings and that it had received confirmation from those undertakings that the loans would continue to be provided for the foreseeable future, being not less than 12 months from the date of signing of the financial statements (February 2008). The amount stated in those financial statements as owing to group undertakings was £3.514 million. Although BHUK is not a "fellow subsidiary", given that the lion's share of K2 Con's intra-Group debt was owed to it, it must be the entity referred to in note 28 that had given the undertaking. That is near-contemporaneous evidence which is inconsistent with the suggestion there was an actual intention that BHUK's loan to K2 Con would be repaid in March 2008. On the other hand, this provides support for the view that BHUK was prepared to take a long-term view as to the recoverability of the debt.

299. Nevertheless, the management accounts (while forecasting that K2 Con would make a loss for the year ended 30 June 2008 of £486,000) did provide reasonable grounds for optimism that in the long-term the debt from K2 Con would be recovered:

i) It was anticipated, on the basis of assumptions regarded by Tenon as reasonable, that K2 Con would return to profitability within a few months and produce a positive cash balance of £515,000 by July 2008;

ii) I have noted above at paragraph 268 the indications by the autumn of 2007 that K2 Con's performance was improving;

iii) The consolidated forecast for the Group showed a positive cash balance across the Group of £4m by June 2008, and positive cash-generation for the year to June 2008 of over £3 million, even after repayment of the whole of the additional lending of £3 million advanced in October 2007 by Mrs Fielding. There were good reasons to take account of the overall Group position given the plans to consolidate the conservatory business by merging K2 Con and Cestrum, and given the flexibility available to the Fieldings, as lenders to the

> Group, as to the use of the funds advanced by them. As at October 2007 I consider it was reasonable to believe that the Fieldings intended to continue to support the Group indefinitely, as demonstrated by the injection of funding immediately following the Distribution.

300. The fact that Tenon saw fit to provide a clean audit opinion on a going concern basis, both in respect of the 2006 and 2007 accounts, is again relevant, in light of the much greater insight Tenon would have had into the trading prospects of K2 Con and the Group as a whole at the time.

301. The claimants rely on the fact that within a year K2 Con had collapsed into insolvency, going into administration in October 2008. I regard this, however, as impermissible use of hindsight. The importance of viewing solvency at a point in the past without hindsight is particularly important when that point in the past is 2007, given the financial crash which occurred a year later. Although Mr Davidson was initially reluctant to accept that the global downturn of 2008 would have taken effect so as to cause the collapse of the conservatory business in the Group by October 2008, when faced with a number of documents which demonstrated that there were significant downward pressures on such businesses over the months prior to October 2008, he accepted that this was indeed the case. Those documents included the financial statements for the Group's direct competitor, the Ultraframe Group, for the year ended 31 October 2008, in which it was stated that a significant fall in turnover, and the need to write down the carrying value in the parent company of the shares in the trading subsidiary (from £32.8 million to £14.43 million) was due in large part to macroeconomic environment and the value of the market for conservatories, which was impacted by consumer confidence.

302. Taking into account the above matters, and recognising that the position in relation to K2 Con is more finely balanced since its financial position was significantly worse than that of Cestrum, I consider that it would have been reasonable to conclude at the time of the Distribution that the debt from K2 Con would in time have been recoverable in full. Delay in recovery of a debt might indicate a need to discount the value of the debt by reason of that delay. Neither expert, however, addressed that possibility and neither party has advanced any arguments on this point.

### *(v) Provision for guarantees*

303. BHUK and K2 Con were each the tenant under long-term lease agreements dated December 2005, although K2 Con occupied both premises. BHUK was the guarantor of the lease entered into by K2 Con. The rent was accrued in K2 Con's accounts and the invoices processed through K2 Con. Although BHUK's liability under its own lease was not strictly a contingent liability, both experts treated it as such for accounting purposes, given that because of its arrangement with K2 Con it would only be required to pay rent if and to the extent that K2 Con was unable to do so. BHUK had also guaranteed the Group banking facility.

304. FRS 12 defines a contingent liability as:

> "(i) a possible obligation arising from past events whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity's

> control; or (ii) a present obligation that arises from past events but is not recognised because it is not probable that a transfer of economic benefits will be required to settle the obligation or because the amount of the obligation cannot be measured with sufficient reliability."

305. The experts were in agreement as to the required accounting treatment of contingent liabilities. FRS 12 states that a contingent liability should not be recognised, albeit that it should be disclosed in the notes to statutory financial statements if the possibility of an outflow of economic benefit to settle the obligation is more than remote. (It is accepted that there is no requirement for notes in Interim Accounts). However, if all the following criteria are met, then a provision should be recognised in the financial statements: (i) the entity has a present obligation (legal or constructive) as a result of a past event; (ii) it is probable that a transfer of economic benefit will be required to settle the obligation; and (iii) a reliable estimate can be made of the amount of the obligation.

306. The claimants contend that a provision should have been included in the Interim Accounts in respect of BHUK's contingent liability under the leases and in respect of the Group bank debt. This contention was not supported, however, by the claimants' own expert: Mr Davidson did not criticise the Interim Accounts on this basis. In re-drawing the Interim Accounts in his first report, he included as an additional provision only an amount in respect of Addleshaw Goddard's legal fees relating to the Distribution.

307. It is true that, in that part of his first report dealing with the Interim Accounts, Mr Davidson noted the existence of the contingent liability in respect of the leases and bank debt, but his opinion on this aspect related to the different point as to the impact of the Distribution on the financial position of the company. He said: "Contingent liabilities are not required to be shown on the face of the balance sheet. However, for the purposes of the preparation of interim accounts to be used as the basis for deciding a distribution, directors should take account of whether, taking the financial position of the company as a whole, including its group balance sheet and its ongoing commitments, it was in a position to make the distribution without jeopardising its financial future." Otherwise, his report addressed these contingent liabilities in the context of considering the solvency of BHUK, which I address at section E8 below.

### *(vi) Provision for legal fees*

308. The Interim Accounts contained no provision for the legal fees of Addleshaw Goddard in connection with their advice relating to the Demerger Transaction, notwithstanding that it is common ground that within a few days of the Distribution part of the legal fees incurred by Addleshaw Goddard, in the sum of £80,000, was charged to BHUK.

309. The contemporaneous documents evidence the following:

i) On 15 August 2007 Mr Joyce opened two files relating to the Demerger Transaction, both of which were in the names of Mr and Mrs Fielding personally. His firm's engagement letter stated that "we will invoice you [i.e.

Mr and Mrs Fielding] for the whole amount of our fees, leaving it to you to apportion contributions between you as you choose."

ii) In an email dated 30 October 2007, Mr Joyce advised Mr Fielding that the total amount of time spent amounted to £120,000. The enclosed billing guides identified the client as Mr and Mrs Fielding.

iii) In the completion statement for the sale of 30% of the shares in Vital to SSE, sent by Mr Joyce to Mr Fielding on 7 November 2007, there is a reference to a "loan to [BHUK] … AG to pay [BHUK's] legal costs (including VAT pf £14,127.49) - £95,044.83"

310. It was Mr Joyce's evidence that it was his understanding until after 30 October 2007 that the Fieldings were personally liable for Addleshaw Goddard's fees, which is why he opened the files in their names. He does not recall a discussion concerning the fees until after sending his email on 30 October 2007, at which point (although he cannot recall the specific discussion) he remembers that Mr Fielding was unhappy with the level of fees. He also remembers that Mr Fielding asked why BHUK should not pay the fees. After debating the issue with Mr Fielding, Mr Joyce opened a new file in the name of BHUK, to which all but £20,000 of the time incurred on the original files was transferred. A new invoice was then raised against BHUK for £80,000 (with the remainder of the transferred amount being written off).

311. The claimants contend that Mr Joyce's evidence was "deeply unsatisfactory" on this issue, criticising his explanation that he assumed that the defendants would be personally liable for the costs because the work he was asked to do was for the benefit of the "Group" and the Fieldings "owned" the Group. The claimants contend that this not only showed a disregard for the concept of legal corporate personality but was inconsistent with Mr Joyce's recent experience in relation to the Ultraframe proceedings where Mr and Mrs Fielding were personally sued (in addition to certain of the Group companies) but the fees (at least latterly) were invoiced to and paid by K2 Con.

312. Notwithstanding this criticism, I accept this evidence of Mr Joyce because it is consistent with the contemporaneous documents. While it is true that his justification that he billed the Fieldings personally because his work was for the benefit of the "Group" demonstrates at best an imprecise understanding of the distinction between Mr and Mrs Fielding and the Group, and of the extent to which the Demerger Transaction was designed to confer at least a cashflow benefit on the Group companies, I consider that at the time it was likely that Mr Joyce understood that Mr and Mrs Fielding, as shareholders, were the principal beneficiaries of a transaction designed to distribute Vital to BHUK's shareholders. Moreover, this was different from the Ultraframe litigation, where although the Fieldings were sued personally, that was because of their actions as shareholders in and directors of the companies.

313. Mr Fielding, in his witness statement dated 12 February 2019 (this issue having been pleaded for the first time by an amendment introduced in January 2019), said that he had assumed the costs would probably be in the region of £40,000 and had been content to pay this amount himself. He says that when he discovered that the costs were in the region of £120,000 he was "extremely cross". Although this was reduced

by Addleshaw Goddard to £100,000, he says that it was at this point that he concluded that the costs should be split between him (£20,000) and BHUK (£100,000).

314. In cross-examination, however, Mr Fielding claimed that he had, prior to the Distribution, had a conversation with Mr Beckett who was pressing him for a figure to put into the Interim Accounts for legal costs, and he had suggested £20,000 (being a 50/50 split of his own estimate of the costs).

315. Mr Beckett, in his witness statement dated 12 February 2019, referred to an entry in the Interim Accounts against the line item "Accruals" in the sum of £39,464.88. He said that he could not recall with certainty what this was made up of, but thinks that it was intended to cover the remainder of the un-invoiced proportion of the £19,000 quoted by Tenon and any additional fees BHUK might incur over and above that (for example legal costs). He went on to say that while he could not recall any conversations about this, he thinks it is "highly probable" that he would have asked Mr Fielding how much the legal fees were going to be, and would have accrued any number he gave him into the Interim Accounts. He repeated this evidence in the witness box, although accepting that he had no actual recollection and that this is just what he "would have" done. He also suggested, for the first time when giving evidence, that the net cost to BHUK was less than £80,000 because he was able to make use of corporation tax group relief by offsetting this cost against one of the other profitable companies.

316. There is no contemporaneous record of Mr Beckett having discussed a 50/50 split of the costs with Mr Fielding in advance of the Distribution. More importantly, the experts agreed that of the figure for Accruals in the Interim Accounts, at least £30,000 existed as at 30 June 2007, and that of the £9,300 incurred in the period between 1 July and the date of the Interim Accounts none of it appeared to relate to the legal costs. Accordingly, I reject Mr Beckett's attempt to reconstruct what he would have done. I also reject Mr Fielding's apparent recollection in the witness box of a discussion with Mr Beckett about splitting the costs 50/50 between him BHUK. It was inconsistent with his witness statement and was in my judgment as much of a (mistaken) attempt at reconstruction as that of Mr Beckett.

317. There remain three possibilities. The first is that no thought at all was given, in the context of the preparation of the Interim Accounts, to the liability for Addleshaw Goddard's costs. The second is that the matter was considered and the position is as Mr Joyce understood it at the time (and as Mr Fielding explained in his first statement) namely that the Fieldings were to bear the costs personally, albeit that this was premised on Mr Fielding's understanding that the costs would be in the region of £40,000. The third is that Mr Fielding knew full well that the costs were to be borne by BHUK but decided to exclude that liability from the Interim Accounts.

318. I reject the first possibility. Given the thoroughness which Mr Beckett brought to his job, I find that he would not have overlooked the obvious point that Addleshaw Goddard would expect to be paid for their work and that the possibility of a provision being made for their costs would need to be considered. Moreover, Mr Beckett expressly considered the possible need to provide for restructuring costs (over and above Tenon's fees) in his email to Ms Brewer of Tenon (copied to Mr Joyce) on 11 September 2007.

319. I also reject the third possibility. There is no evidence to suggest that Mr Fielding intended that the Interim Accounts should be anything other than accurate. It would have made no sense to falsify the Interim Accounts in this way in circumstances where (1) there was known to be a deficiency in distributable reserves as at 30 June 2007; (2) this was to be rectified by a distribution of £300,000 from K2 Glass; and (3) there was plenty of headroom within the distributable profits in K2 Glass to increase the dividend to cover the additional provision in respect of Addleshaw Goddard's legal costs.

320. Accordingly, I find that the most likely explanation is the second, namely that Mr Fielding did indeed intend, at the time of the preparation of the Distribution that he would bear Addleshaw Goddard's legal costs personally, albeit that this intention was premised on his mistaken assumption that the costs would be in the region of £40,000.

321. The experts are agreed that FRS 12 is the accounting standard that would have applied to the treatment of accruals at the time the Interim Accounts were prepared and that, in accordance with this standard, if BHUK had incurred a liability for the cost of the legal fees in the period of the Interim Accounts (that had not already been accrued for as at 30 June 2007) then those costs should have been accrued for and included as expenses in the Interim Accounts. Paragraph 14(a) of FRS 12 states, as one of the necessary conditions for recognising a provision, that "an entity has a present obligation (legal or constructive) as a result of a past event." Paragraph 15 states that "in rare cases it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the balance sheet date." Paragraph 17 states as follows:

> "A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only: (a) where the settlement of the obligation can be enforced by law; or (b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation."

322. In my judgment, the legal conclusion which follows from my findings of fact on this issue is that BHUK had not actually incurred an obligation (whether legal or constructive) in respect of the costs prior to the date of the Distribution.

323. The only evidence of any contract for the provision of legal services in connection with the Distribution is the engagement letter between Addleshaw Goddard and Mr and Mrs Fielding. This is corroborated by the fact that Mr Joyce opened files, specifically to deal with the Demerger Transaction, in the names of Mr and Mrs Fielding personally. Accordingly, I find that there was no legal obligation upon BHUK to pay Addleshaw Goddard's costs prior to the date of the Distribution.

324. I also find that by the date of the Distribution, had Mr Fielding or Mr Beckett thought to ask Mr Joyce what the likely level of fees would be, they would have learned that the final figure was likely to be in the region of £110,000 to £120,000. That is

because in the billing guide attached to Mr Joyce's email of 30 October 2007 to Mr Fielding, all but approximately £11,000 of the total amount had been incurred on or before 12 October 2007. I infer, from the fact that when Mr Fielding found out that the costs were of this order of magnitude, he determined that it was appropriate for BHUK to bear the lion's share, that he would have made the same determination had he learned this before making the Distribution.

325. The consequence of this is that, in the circumstances that in fact existed as at 12 October 2007, it was highly likely (although unknown to both Addleshaw Goddard and Mr Fielding) that BHUK would thereafter be burdened with a substantial part of Addleshaw Goddard's costs. Nevertheless, that did not translate into either a current legal obligation or to something which created valid expectations in other parties (in particular in Addleshaw Goddard, as the entity to whom payment was owed) that BHUK would discharge the obligation so as to constitute a current constructive obligation.

326. Accordingly, applying (as both experts agree) FRS 12, I conclude that the Interim Accounts were not in error in failing to make provision for the Addleshaw Goddard costs.

***Conclusion***

327. For the above reasons I conclude that the Distribution was not rendered unlawful either on the basis of a lack of distributable profits or on the basis that the Interim Accounts were such that no reasonable judgment could be made as to the matters identified in s.270(2) of the 1985 Act.

## E7. Were the defendants at fault in causing the Distribution to be made?

328. I have set out the circumstances surrounding the Demerger Transaction, and the making of the Distribution, in section E2 above. Taking into account those circumstances, I consider that even if the value of any of the assets in the Interim Accounts ought to have been written down, or other liabilities included (save only for a provision in respect of Addleshaw Goddard's legal fees in the sum of £80,000, which I deal with separately below), and even if that would have resulted in there being insufficient distributable reserves to enable the Distribution lawfully to be made, then Mr and Mrs Fielding were not culpable so as to be in breach of duty in causing the Distribution to be made.

329. I base that conclusion on the following summary points, on which I expand as necessary below.

i) Mr and Mrs Fielding relied on Mr Beckett and his team to prepare the management accounts for all of the Group companies, including the Interim Accounts. They also relied on Mr Beckett, his finance team and Tenon Audit to prepare statutory accounts for all companies in the Group.

ii) Mr and Mrs Fielding (as well as Mr Beckett) relied on Tenon CF and Addleshaw Goddard to advise and prepare relevant documentation in connection with the Distribution (the responsibility for the Distribution being

divided between Addleshaw Goddard and Tenon CF in the steps plan produced by Tenon CF in August 2007).

iii) To Mr and Mrs Fielding's knowledge, from about August to the date of the Distribution Mr Beckett was working closely with Tenon CF and Addleshaw Goddard in preparation for the Distribution – including in ensuring that there were sufficient distributable reserves – and at the same time was working closely with Tenon Audit in producing the statutory accounts for BHUK and all of the Group Companies for the year ended 30 June 2007.

iv) Full information was made available to BHUK's advisors concerning the financial position of BHUK and its subsidiary companies.

v) In all the circumstances, it was reasonable for Mr and Mrs Fielding to rely upon Mr Beckett and the professionals referred to in the preceding paragraphs in concluding that the Interim Accounts were prepared in accordance with the requirement of the Companies Act and that there were sufficient distributable reserves to enable the Distribution to be made.

330. FRS 11 entitles a company to continue to include fixed assets at cost unless the recoverable amount is less than the carrying value, and this involves a judgment as to the value in use or net realisable value of the relevant income generating unit. These are accounting concepts, on which it would be expected that directors would look, first, to the finance director and accounting department and, second, to external auditors, for guidance.

331. Similarly, the question whether a debt may be included at full value, or should be impaired in light of its recoverability (or lack of it) involves a question of judgment, having regard to the financial position of the debtor. This is also a question on which directors would look to the finance director and external auditors.

332. That is in my judgment what happened in the case of BHUK. As I have described in section E2 above, it is clear that Tenon Audit were closely involved in reviewing the assets and liabilities of BHUK for the purposes of auditing the accounts of BHUK and each of the other companies in the Group. The disclosure relates only to certain of the financial statements for the years ending 30 June 2006 and 30 June 2007. I infer, however, that there had been a similar level of engagement in previous years. Moreover, as would be expected in relation to a Group the size of the Burnden Group, the auditors communicated extensively with the finance director, Mr Beckett and his team.

333. Within the disclosure provided by Tenon Audit there are numerous versions of detailed statutory accounts packages for each company, handwritten notes and notes of meetings with Mr Beckett and Mr Martin. Together these demonstrate a high level of knowledge on the part of Tenon Audit of the detailed financial position of each Group company. Specific attention was paid, in considering BHUK's statutory accounts in 2006 and 2007, to the need for impairment both as regards the goodwill in subsidiary companies and the value of inter-company balances.

334. It is important to note in this regard that, since Tenon Audit were intimately involved in the preparation of accounts for each of the Group companies, and were presented

with cash flow forecasts for each of them, they were already aware of the information necessary to form a judgment as to the recoverability of debts due from those entities. In other words Tenon Audit were intrinsically better informed about the financial circumstances of each debtor than they would have been if the debts were owed by independent third parties.

335. Although Tenon were not concerned in creating, or reviewing, the Interim Accounts, those accounts were simply taken from the same software package from which the statutory accounts packages were prepared, which were heavily reviewed by Tenon Audit in assisting in the preparation of, and audit of, the 2006 and 2007 statutory accounts.

336. The asset/liability position of BHUK, as a non-trading holding company, was straightforward, and largely unchanged from year to year. There was certainly no substantive change between the position as at 30 June 2007 and the date of the Distribution, save for the revaluation of Vital, the dividend from K2 Glass and relatively minor movements on inter-company balances. In those circumstances, it is of particular relevance that – to Mr and Mrs Fieldings' knowledge – Mr Beckett was liaising in parallel with Tenon CF, in preparing for the Distribution and with Tenon Audit, in preparing the statutory accounts.

337. If any of the write-downs contended for by the claimants ought to have been made in the Interim Accounts, then it necessarily follows that the same write-downs should have been made in the statutory accounts for BHUK for the year ended 30 June 2007. It is not suggested that there was any change of circumstances between 30 June 2007 and 12 October 2007 which would have required a relevant adjustment to the Interim Accounts but not to the statutory accounts. Yet Tenon Audit (with far more information than is now available) did not consider it necessary to impair any of BHUK's assets.

338. In these circumstances, I conclude that it was reasonable for Mr and Mrs Fielding to rely on Mr Beckett, Tenon CF, Tenon Audit and Addleshaw Goddard to, between them, ensure that BHUK complied with the requirements necessary to enable the Distribution to be lawfully made.

339. The position is different, however, in relation to the provision for Addleshaw Goddard's legal fees (assuming, contrary to my conclusion above, that one was required), for the following reasons. If such a provision had been included in the Interim Accounts, then the amount of distributable profits would have fallen short by approximately £26,000. On the assumption that my conclusion that such a provision was not required is wrong, then I consider that Mr Fielding was at fault in failing to include that provision. This follows from my findings that (1) he intended, at the time of the Distribution, that he would pay Addleshaw Goddard's costs, but (2) this was based on his belief that the costs would be in the region of £40,000 and (3) if he had asked Mr Joyce at the time of the Distribution what the costs were likely to be he would have been told that they were in the region of £110,000 to £120,000. In my judgment, on the assumption that a provision should in those circumstances have been made in the Interim Accounts, then although I find that he was genuinely unaware of the need to make a provision, his failure to do so was as a result of his own failure to act as a reasonable director would have acted, and thus he must be taken to have known the facts which rendered the Distribution unlawful. On the basis of the

standard required of directors, as set out in the judgment of Nelson J in *Bairstow* (above at paragraph 148), I conclude that he was at fault. There is no evidence that Mrs Fielding was aware of his thinking on this point, or that she ought to have appreciated the possibility that an additional liability for legal fees should have been included in the Interim Accounts. Accordingly, I do not find that she was at fault in this respect.

## E8. Was the Distribution a dishonest breach of fiduciary duty by the Directors under s.172(3) of the 2006 Act?

### *Introduction*

340. It is common ground that BHUK was solvent as at 12 October 2007 immediately prior to the Distribution, while it still owned Vital. It is the claimants' case, however, that immediately following the Distribution BHUK was substantially insolvent on the balance sheet basis.

341. This issue gives rise to two questions: (1) was BHUK rendered insolvent as a result of the Distribution? (2) if so, did the defendants know it? As I have already noted, there is no alternative claim that the defendants ought to have known that BHUK would be rendered insolvent as a result of the Distribution.

### *The legal test*

342. Section 172(3) of the 2006 Act provides that: "the duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company".

343. The duty to consider or act in the interests of creditors is engaged when the company is or is likely to become insolvent, where "likely" means probable: *BTI 2014 LLC v Sequana S.A.* [2019] EWCA Civ 112, per David Richards LJ at [220].

344. It is trite law that a company is insolvent if it is unable to pay its debts, and that the two primary tests to establish whether that is so are: (1) the cash flow, or commercial insolvency, test, found in s.123(1)(e) of the Insolvency Act 1986, which asks whether the company is able to pay its debts as they fall due; and (2) the balance sheet test, found in s.123(2) of the Insolvency Act 1986, which asks whether the company's assets are sufficient to discharge its liabilities.

345. In relation to BHUK, which was a holding company funded primarily by lending from the Fieldings and with very little in the way of debts falling due from time to time to third parties, the principal focus is on the balance sheet test.

346. The balance sheet test is encapsulated in *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc* [2013] 1 WLR 1408, per Lord Walker JSC at [42] (with whom Lord Mance, Lord Sumption and Lord Carnwath JJSC agreed), quoting with approval from Toulson LJ's judgment in the Court of Appeal in that case:

> "Essentially, section 123(2) requires the court to make a judgment whether it has been established that, looking at the company's assets and making proper allowance for its

> prospective and contingent liabilities, it cannot reasonably be expected to be able to meet those liabilities. If so, it will be deemed to be insolvent although it is currently able to pay its debts as they fall due. The more distant the liabilities, the harder this will be to establish."

347. The burden lies on the party asserting that the company is balance-sheet insolvent: *Eurosail*, per Lord Walker JSC at [37].

348. Only the present assets of the company are to be taken into account: see *Eurosail* at [37] and *Byblos Bank SAL v Khudhairy* (above); *Re Rococo Developments Ltd* [2017] Ch 1, per Lewison LJ at [19]-[20], citing Sir Andrew Morritt C in *Eurosail* at first instance ([2011] 1 WLR 1200, at [30]).

349. It is inherent in the *Eurosail* test that, while the amounts recorded in the financial statements of a company for its assets and liabilities constitute evidence of, and may even be a starting point for considering, their value, the focus must be on their commercial value. Lord Neuberger, at [61] of his judgment in the Court of Appeal, discussing the relevance of the figures in the company's audited accounts, said this:

> "I do not think that it is possible or helpful to describe in general terms the weight to be given to such figures in such an exercise. Clearly, the fact that the figures have been audited and are said to convey a "true and fair" view of the company's position in the opinion of its directors should normally have real force. However, the figures will inevitably be historic, they will normally be conservative, they will be based on accounting conventions, and they will rarely represent the only true and fair view."

350. Although that passage concluded with a reference to a test ("the point of no return") which was discredited in the Supreme Court, his comments in relation to the relevance of the company's statutory accounts remain valid.

351. This is of particular relevance in the present case in relation to two classes of assets: the company's investment in the shares of its subsidiaries (carried at historic cost) and the debts due from its subsidiaries (carried at face value). Whether or not these were accounted for correctly, in considering insolvency it is the real value of the assets that needs to be considered.

352. Similarly, a commercial view must be taken of the company's contingent and prospective liabilities. They are not simply to be included at their face amount on the liabilities side of the balance sheet. Instead, "proper allowance" is to be made for future and contingent liabilities "discounted for contingencies and deferment" (see *Eurosail* in the Supreme Court, per Lord Walker JSC at [37] and [42]). In the case of contingent liabilities, this requires a series of commercial judgments to be taken, as to the likelihood of the contingency falling in, the date it might do so, the amount of that liability, and the appropriate discounts to apply in relation to each aspect: see, for example, Goode on Principles of Corporate Insolvency Law, 5th ed., para 4-39.

### *The claimants' arguments as to why BHUK was insolvent*

353. The claimants' principal argument is that BHUK was, or was likely to become, insolvent as its solvency depended on the solvency of K2 Con and Cestrum: those companies were insolvent, so it follows that BHUK was insolvent.

354. While I accept there is a relationship between BHUK's solvency and that of its subsidiaries, it is more nuanced than the claimants suggest.

355. First, the value in the shares of a subsidiary will be affected by its insolvency. However, as I describe below, it does not follow from the fact that a subsidiary is insolvent that there is no value in its shares, since a company with positive future trading prospects can have a significant value notwithstanding its current insolvency.

356. Second, in the event that BHUK had guaranteed the debts of a subsidiary (e.g., K2 Con), then that subsidiary's insolvency may require a value to be put upon that guarantee liability because it increases the prospect of that liability being called upon. Again, however, it does not follow from the mere fact that the subsidiary is insolvent that BHUK would be required to satisfy those liabilities. Even though the subsidiary is balance sheet insolvent, provided that it has both the cash to overcome short to medium term cashflow difficulties and a prospect of future profits, then it would be reasonable to regard the likelihood of the guarantee being called upon as low. In other words, the critical issue is not whether the subsidiary is insolvent, but whether it is likely to be able to pay the guaranteed liabilities. Even if that was only possible with continued support from the ultimate shareholders (the Fieldings), that would be a reason for concluding that BHUK, even though it had guaranteed certain of K2 Con's debts, remained solvent.

357. The claimants rely on the repeated references in board minutes (and meetings with Tenon Audit) between May and October 2007 to the Group's need for cash. They also point to admissions by Mr Fielding and others that without the injection of cash to which the disposal of shares in Vital to SSE gave rise, the companies involved in the conservatory business would have gone into a formal insolvency process. They also rely on various "indicia" of insolvency in respect of entities within the Group such as non-payment of VAT, dwindling profits and receipt of advice on insolvency. They pray in aid (in reliance on *Bucci* – see above at paragraph 289) that an insolvent company does not cease to become insolvent by acquiring funds from further borrowing.

358. In my judgment, however, this falls into the trap of conflating the fact of K2 Con's insolvency with the value to be placed both on debts due from K2 Con to BHUK and on the guarantee liabilities entered into by BHUK in respect of K2 Con's debts.

359. The claimants contend that it is wrong to take into account the cash injection resulting from the Demerger Transaction, in assessing the balance sheet of BHUK as at the time of the Distribution, because the balance sheet in the Interim Accounts included Vital as an asset, whereas the cash injection was premised upon Vital having been removed. I reject this argument. The relevant question is whether BHUK was solvent immediately following the Distribution (it being common ground that it was solvent prior to it). It is clearly correct, in this context, to include the cashflow benefit arising from the Distribution.

360. Even if it was relevant to consider the position immediately prior to the Distribution (for example, in considering the validity of the Interim Accounts) then I consider it was nevertheless appropriate to value the investments in, and debts due from, subsidiaries on the basis that they would receive sufficient cash to see them through the imminent cashflow problems. That is because the balance sheet immediately prior to the Interim Distribution reflected BHUK's ownership of the shares in Vital, having a substantial value (in the region of at least £10 million), which on the assumption there was no Distribution would have been available to BHUK to generate in some other way the necessary cash to support the remainder of the Group.

***The value of BHUK's assets and liabilities***

361. I turn to address directly the value of the assets and liabilities of BHUK as identified in the Interim Accounts. These recorded that:

    i) The principal assets of BHUK were:

        a) investments in subsidiaries (with the following amount included as historic cost): K2 Glass (£2,534,736); TBG (£1,115,679); SGI (£250,000); Cestrum (£1); and K2 Con (£1,000);

        b) debts due from subsidiaries (in the following amounts): Cestrum (£1,900,958); and K2 Con (including liabilities transferred to K2 Con from TBG, of £2,187,144); and

    ii) The principal liabilities of BHUK were:

        a) a director's loan (in the sum of approximately £2.82m); and

        b) a debt due to K2 Glass (£889,869).

362. As noted in section E6 above, the claimants contend that there was no value in BHUK's investments in K2 Con and TBG, or in the debts due from K2 Con and Cestrum. Accordingly, its only asset of any value was its investment in K2 Glass. Although Mr Davidson's evidence was that this should be written down to £663,083 (reflecting a revised net asset value of £413,000 and an estimated amount for goodwill of £250,000), in closing submissions the claimants accepted that the value of K2 Glass was at least as high as its carrying value of £2,534,736.

363. The claimants therefore contend that, even assuming BHUK's liabilities were merely those stated in the Interim Accounts, it was balance sheet insolvent. In addition, however, the claimants contend that BHUK's liabilities were substantially greater than those recorded in the Interim Accounts, and included the following:

    i) A contingent liability in respect of the leases of premises occupied by K2 Con. Mr Davidson estimates this liability for the purposes of the balance sheet test as £250,000;

    ii) A contingent liability in respect of BHUK's guarantee of its subsidiaries' indebtedness to the Royal Bank of Scotland. Mr Davidson estimates this liability for the purposes of the balance sheet test as £500,000;

iii) A contingent liability in respect of BHUK's guarantee of its subsidiaries' indebtedness to the Fieldings. Mr Davidson estimates this liability for the purposes of the balance sheet test as £850,000.

364. I have already addressed many of the points raised by the claimants in this respect when dealing with the adequacy of the Interim Accounts, and I will cross-refer to passages in section E6 of this judgment where necessary.

***Investment in subsidiaries***

365. Where, as in the case of BHUK, subsidiaries are accounted for on the historic cost basis, this is unlikely to be a guide as to their real value, except where upon an impairment review the carrying value has been reduced to match the asset's value in use or net realisable value.

***K2 Glass***

366. The carrying value of K2 Glass in the Interim Accounts of BHUK was £2,534,736, representing the purchase price for the shares on acquisition by BHUK in 2003. At the date of acquisition it had net assets of £608,868 and purchased goodwill of £1,925,869 (the latter being recognised in BHUK's consolidated accounts only).

367. Its audited financial statements for the year ending 30 June 2007 indicate that it had net assets of £1,937,791

368. The claimant's expert, Mr Davidson, concluded, in his first report, that (1) the net assets should be written down to £413,083 (as a result of writing off completely amounts due from BHUK and K2 Con) and (2) the goodwill should be written down to £250,000, resulting in a revised value for K2 Glass as an investment asset of £663,083.

369. Mr Davidson took account of the following in arriving at his conclusion: it was a relatively small company (with revenues of between £3.3 million and £3.6 million over the past four years, its operating profits had dropped from £693,000 in 2004 to a loss of £5,500 in 2007, its gross profit margins had dropped over the same period from 47.3% to 27.9% and it appeared to have increased costs. He noted that intercompany loans (most of which were due from BHUK) were written off in 2008. He accepted that there was no particularly scientific calculation in arriving at goodwill of £250,000.

370. It is important to note that Mr Davidson's conclusion as to the value of K2 Glass is based almost entirely on its then current net asset position and past trading performance. He took no account of its future prospects. This is to be contrasted with his approach when valuing Vital, where he said: "the most technically correct way to value any entity, particularly one generating or expected to generate positive cashflows, is by calculating the net present value of future cash flows." Moreover, as I have explained above in dealing with the adequacy of the Interim Accounts, upon an impairment review FRS 11 defines the "recoverable amount" as either the value in use of the income generating unit, or its net realisable value – both of which are calculated on the basis of discounted future cash flows.

371. It is fair to point out that the experts were in some difficulty in considering the value of BHUK's investment in its subsidiaries on this basis, given the fact that the cash flow projections prepared for K2 Glass and other Group companies were not available to them. Nevertheless, there are a number of pieces of evidence that indicate that K2 Glass was reasonably anticipated to produce positive cashflows in the coming years, as at the date of the Distribution.

372. First, in Appendix 1 to the impairment review carried out in February 2007, the value in use for K2 Glass was calculated to be £4.95 million, based on a forecast positive cashflow of £382,000 for the first year (with the same number being assumed for subsequent years). As I have noted above, while the underlying forecasts are not available, there is evidence that Tenon had reviewed forecasts for (among other companies) K2 Glass at around this time and had commented that they were based on reasonable assumptions.

373. The claimants contended that 'value in use' was irrelevant as a guide to K2 Glass' value, even though it was based on a similar discounted cashflow analysis as a valuation based on net realisable value, because a company's worth is the worth it has "in the eyes of a third party, not the worth it has in the eyes of the directors". I reject that contention. While it may be that a valuer would treat the directors' own projections of future performance with more caution than those of a third party, that is not a reason for excluding them altogether. Moreover, in the case of K2 Glass, by the time of the Distribution, it was outperforming those projections. I also note that Mr Davidson's valuation of Vital on a discounted cash flow ("DCF") basis was based on the projections provided by management.

374. Second, while it is true to say that in 2007 K2 Glass had made an operating loss (of £3,514), its operating profit had been approximately £442,000 in each of the two prior years.

375. Third, there are numerous indications that K2 Glass's performance throughout 2007 was significantly better than anticipated. In an email dated 20 September 2007 from Mr Beckett to a Mr David Sheehan of GE, sent in relation to the proposed dividend from K2 Glass (and copied to, among others, Ms Brewer of Tenon), he referred to latest financial projections for K2 Glass (enclosed with the email, but not in evidence) and said: "K2 Glass has sold well above budget in July and August and we believe that it will generate profitability in excess of these projections." Tenon's note of the 2007 Audit exit meeting on 30 October 2007 stated: "K2 Glass is very profitable. It is limited by capacity now with more orders than it can cope with." In Tenon's note of an audit clearance meeting on 30 November 2007, it was stated that "K2 Glass is flying". In management accounts produced in about December 2007, K2 Glass was shown as having produced higher actual sales and profits than had been used in relation to the impairment review earlier that year.

376. Fourth, in those same management accounts, K2 Glass was forecast to make an operating profit of £452,000 in the year to 30 June 2008. Tenon Audit were satisfied that the detailed forecasts underlying these management accounts (the detailed forecasts were not in evidence) were based on reasonable assumptions.

377. The above evidence is sufficient, in my judgment, to indicate that had a valuation of K2 Glass been carried out on the basis of its anticipated future trading prospects, then

it would have produced a sum substantially greater than that arrived at by Mr Davidson.

378. In the absence of either expert having undertaken such a valuation, it is impossible for me to conclude what would have been a reasonable sum to include in BHUK's balance sheet for the value of K2 Glass. The burden lies on the claimants to establish that the value of BHUK's assets was less than the value of its liabilities. In circumstances where the only available evidence of K2 Glass' value is the impairment review undertaken in February 2007, I consider that there is at least *prima facie* evidence of value in the region of £4-5 million. I accept that caution is necessary in relation to the valuation arrived at on the impairment review, because the calculation was undertaken merely to show that the recoverable amount was at least as much as the carrying value. On the other hand, that is counterbalanced to some extent by the fact that K2 Glass' performance improved significantly after the date of the review. While the claimants accepted, in closing argument, that K2 Glass was valued at its carrying value of £2,534,736, I note that there is no logical basis for landing on this figure since it is accepted by both experts that the historic cost of the asset is no guide to its actual value some four years after the date of the acquisition.

***Cestrum***

379. The carrying value of Cestrum in the Interim Accounts was a nominal £2. Mr Davidson considers that the value of BHUK's investment in Cestrum was nil. As with K2 Glass, his conclusion is based on its current net asset position and past trading performance, with no account taken of its future trading prospects but, again like K2 Glass, there were indications at around the time of the Distribution, of significant anticipated improvement in Cestrum's future prospects such that a valuation based on future cashflows would have produced a substantial number.

380. First, in the impairment review of February 2007, BHUK's investment in Cestrum was valued at £12.862 million, based on an annual positive cashflow of £992,000. The "best case" cashflow forecast, regarded by Tenon Audit as based on reasonable assumptions, from around this time forecast an operating profit in the year to March 2008 of £1.285 million for Cestrum.

381. As against this, it is clear that Cestrum's performance in the first half of 2007, along with the remainder of the conservatory business, was significantly worse than the worst-case forecasts from earlier that year. In the management accounts prepared in December 2007 an operating loss of £139,000 was forecast.

382. Nevertheless there were signs of an anticipated upturn in the first quarter of 2008: see paragraph 288ff above.

383. Neither expert attempted a valuation of Cestrum based on anticipated future performance. Since the forecast which underlay the impairment review calculation in February 2007 appeared hopelessly optimistic, from the standpoint of October 2007, I regard the valuation of £12.862 million contained in that review as itself highly optimistic. On the other hand, I consider that the anticipated increase in turnover as a result of the B&Q contract, combined with anticipated savings in overheads, would have indicated a substantial value for Cestrum had a valuation been undertaken at the time of the Distribution.

***K2 Con/TBG***

384. I have already concluded (see paragraph 272 above) that while the valuation arrived at in the impairment review of February 2007 in respect of K2 Con was unrealistically optimistic, and while I do not have the information or assistance from the experts to estimate what value it did have, it did have a value greater than the £1,000 attributed to it in the Interim Accounts. Moreover, I have concluded that it would not have been unreasonable to accord a value to TBG equal to the net asset value disclosed in its financial statements (of £450,000).

***Debts due from subsidiaries***

385. I have considered the appropriate value, as at October 2007, of the debts due to BHUK from Cestrum and K2 Con in section E6 above. For the reasons there set out, I concluded that it was reasonable, at that time, to regard the debts as having a value equal to their face value.

***Conclusion on insolvency based on the value of BHUK's assets***

386. Based on my consideration of the value of BHUK's assets, alone, I conclude that the claimants have not discharged the burden of showing that BHUK's assets were worth less than its liabilities, even if making "proper allowance" for its contingent liabilities required a provision to be included in the sum contended for by the claimants.

387. Thus, if the full amount of the provisions contended for by the claimants in respect of lease liabilities and the Fieldings' lending to subsidiaries were included as liabilities, BHUK's total liabilities amounted to approximately £4.8 million. For the detailed reasons set out above in relation to each of the assets, the claimants have not discharged the burden of establishing that the value of BHUK's assets was less than that sum. (I leave out of account any provision in respect of the guarantee of the Group debt to Royal Bank of Scotland, as I accept the unchallenged evidence of Mr Fielding that the bank debt had been fully repaid in January 2006, after which the lending continued on the basis of an "offset facility", such that the overall balance across the Group had to be zero. While the figures included in the 2007 audited accounts suggest that at that point in time there was a balance due to the bank, I accept Mr Beckett's explanation that this was due to the timing of receipts and payments over the month end. More importantly, the management accounts prepared in December 2007 illustrated that while at the end of September 2007 there had been a small balance owing to the bank, this was cleared immediately and that for every month thereafter there was anticipated to be a positive balance across the Group. Accordingly, there was no possibility of BHUK being called upon under its guarantee to the bank.)

388. The claimants had proceeded until after the end of the oral evidence at trial on the basis that the lending from the Fieldings had been correctly recorded in the Interim Accounts, i.e. that while total lending from the Fieldings to the Group was in the sum of approximately £4.5 million, BHUK's own liability was in the sum of approximately £2.8 million. After the close of the oral evidence, the claimants sought to amend their claim to add a further basis on which the Interim Accounts were said to be flawed, namely that the true amount of lending from the Fieldings to BHUK was £4.5 million. I refused permission to amend on the basis that it would

have necessitated an adjournment to permit the defendants to address the point by way of further evidence. Although on the face of it, the loan agreement of 9 July 2007 envisaged all of the Fieldings' lending being consolidated with BHUK as the borrower, it was clear that this was not how the lending was treated in practice across the Group. In their closing argument, the claimants relied solely upon BHUK's liability as guarantor in respect of the borrowing of other Group companies.

389. If the claimants' argument that the whole of the Fieldings' lending to the Group should be included as a liability of BHUK was accepted, that would not have altered BHUK's net asset position, because the increase in its debt to the Fieldings would be matched by an increase in the debt due to it from whichever of the subsidiaries had utilised the funds. Similarly, there would have been no change in the relevant subsidiaries' net assets, because the debt due to the Fieldings would be swapped for a debt due to BHUK. In any event, even if the whole of the Fieldings' lending is treated as due from BHUK, and no account is taken of any increase in amounts due from subsidiaries, the total of BHUK's liabilities would have been approximately £5.8 million, and the claimants have not established that its assets were worth less than that sum.

390. In light of this conclusion, it is unnecessary to consider whether making allowance for the contingent liabilities would have required provisions to be included in the sums contended for by the claimants. I nevertheless consider that it would have been reasonable to make little or no provision in respect of them, as at October 2007, for the following brief reasons.

391. I have very little information on which to form a judgment as to the likely quantum of any claim against BHUK in respect of the leases, other than that there was an annual cost of £520,000 and that the rent was paid on the due dates up to 30 September 2008. There is no evidence, for example, as to what claim the landlord could make in the event that the leases were disclaimed in the liquidation of either K2 Con or BHUK. So far as the likelihood of any claim being made at all is concerned, for the reasons which I have set out above when considering the view (as from October 2007) of K2 Con's future prospects, I consider that it would have been reasonable to conclude that the conservatory business was likely to be able to continue, and to be able to pay the ongoing rent under the two leases, for the foreseeable future. I take account of the fact that it was intended to amalgamate the business of Cestrum (which it was anticipated would be very cash generative) with that of K2 Con, which would have lent support to the view that the business could continue to pay future rent.

392. So far as the guarantee of the Fieldings' lending to subsidiaries is concerned, I conclude that it would have been reasonable, in October 2007, to regard the Fieldings as committed to providing long-term support to the Group, as demonstrated both by their past behaviour and their willingness to inject a further £3m million of debt immediately following the Distribution.

393. Accordingly, if it had been appropriate to include any amount by way of provision in the balance sheet for these contingent liabilities as at October 2007, I consider that it would have been de minimis.

***If the Company was insolvent or likely to become insolvent, did the Defendants know this?***

394. I have set out in some detail, in section E2 above, dealing with the genesis and development of the Demerger Transaction, the contemporaneous documents, such as board minutes and minutes of meetings with Tenon, which refer to the financial state of BHUK in the months leading up to the Distribution. I have also referred in section E6 above to the minutes of meetings with Tenon, and management accounts produced, in the immediate aftermath of the Distribution which also bear on this issue. On the basis of that contemporaneous evidence, even if my conclusion that BHUK was not rendered insolvent as a result of the Distribution is wrong, I find that neither of the Defendants was aware that BHUK was insolvent.

395. I rely in particular on the fact that there is no reference in any contemporaneous documents to the directors (let alone the defendants) having appreciated that BHUK was at any time insolvent. Moreover, notwithstanding (i) that Tenon Audit was aware of the financial position of BHUK and all other companies in the Group and also aware of the proposed Distribution, and (ii) that Tenon CF was closely involved with the Distribution and in ensuring there were sufficient distributable reserves, at no stage did anyone from Tenon suggest to the directors that BHUK was insolvent.

396. It is true that the directors did expressly consider, and were advised as to, the insolvency of K2 Con but, for reasons which I have addressed above, that falls far short of establishing knowledge of insolvency of BHUK.

397. The claimants contend that it is enough to establish that the defendants knew of the cashflow difficulties facing the Group, the likelihood (absent any action) of K2 Con and Cestrum entering a formal insolvency procedure, and the impact on BHUK if K2 Con and/or Cestrum were to enter into a formal insolvency procedure.

398. I reject that contention. First, it is wrong to equate the financial circumstances of the Group with the solvency or insolvency of BHUK.

399. Second, it is wrong to equate knowledge of cashflow insolvency of K2 Con with knowledge that BHUK was itself insolvent. The claimants' argument conflates the position of a single company (whose balance sheet insolvency is not cured by further lending to it) and the position of a holding company such as BHUK, whose assets include a debt due from a subsidiary and which is contingently liable for debts of the subsidiary. In the latter case (as I have explained above) the value of the holding company's asset and the likelihood of its contingent liability crystallising are dependent, not on the solvency status of the subsidiary, but on the ability of the subsidiary to continue trading and paying its debts as they fall due, even if that is achieved only with further lending to the subsidiary.

400. Third, it is irrelevant (from the perspective of BHUK's solvency) that the defendants knew that *without further funding* K2 Con would have to go into an insolvency process, because in fact they knew that further funding was available. The critical question, therefore, is whether the defendants knew that even with a further £3 million of funding for the Group, resulting from the Demerger Transaction, K2 Con and Cestrum were likely to go into a formal insolvency process such that there was no value in the debts due from them, and BHUK's contingent liabilities under the leases would be crystallised. In my judgment, they honestly believed that the funding that would be made available following the Distribution and the sale to SSE of Mrs

Fieldings' interest in Vital would be sufficient to enable the Group to trade through its difficulties.

401. Accordingly, given that no case is alleged that the defendants "ought to have" known of BHUK's insolvency, the duty to take into account the interests of creditors did not arise, and it is unnecessary to consider whether the defendants failed to do so.

## E9. Could any breach of duty be ratified by the Company's members, and was it?

402. I have considered at paragraph 171 above the application of the *Duomatic* principle to the question whether the directors of BHUK complied with any formalities required in convening a meeting to consider the Distribution. Aside from that, the issue of ratification does not arise even if my conclusion that there was no breach of duty was wrong. That is because if there was a breach of duty consisting of either (1) breaches of mandatory provisions of Part VIII of the 1985 Act or (2) failing to take into account the interests of creditors in circumstances where the company was, or was likely to become, insolvent it is common ground that the *Duomatic* principle does not apply.

## E10. Was the Distribution a transaction at an undervalue within s.423 of the Insolvency Act 1986? If so, was it undertaken for the proscribed purpose?

403. It is now settled law, following the decision in *Sequana* (above) that the payment of a dividend is capable of constituting a transaction at an undervalue within the meaning of s.423 of the 1986 Act.

404. The only issue in this case, therefore, is whether the defendants' intention in making the Distribution was to put the shares in Vital beyond the reach of creditors. The purpose must be a real substantial purpose (not merely a by-product of the transaction under consideration) but it does not need to be the sole or dominant purpose: *IRC v Hashmi* [2002] BCC 943, at [23]-[25] per Arden LJ.

405. Although knowledge of insolvency, whether at the time of the transaction or in consequence of it, is not a necessary precondition for a finding that the requisite purpose was present, it is at least a relevant consideration that the defendants did not (as I have found above) believe that BHUK was rendered insolvent as a result of the Distribution. That is because prejudice to creditors is more remote if the company's solvency is not affected by the transaction. It remains possible that the defendants nevertheless envisaged a potential future insolvency of BHUK and sought to insulate Vital from that eventuality.

406. In my judgment, however, that was not their purpose. I have set out the evidence that relates to this issue in reciting the history of the Demerger Transaction. On the basis of that evidence, I find that the defendants' original purpose in making the Distribution was principally to benefit the business of Vital by separating it from the conservatory business, in particular because this would improve the prospect of retaining and attracting employees by enabling an employee share incentive scheme to be operated free from any association with the conservatory business. This remained their purpose up until the time of the Distribution, but I also find that it was

by then part of their purpose to benefit the remaining companies in the Group by (1) acquiring a £3 million cash injection by way of the immediate sale of 30% of the shares in Vital to SSE, with half of the proceeds being loaned to the Group and (2) writing off inter-company loans due to Vital. I find that the defendants did not give thought to a potential insolvency of BHUK in deciding to effect the Distribution.

407. The claimants rely on a reference in a witness statement of Mr Fielding, when explaining the reasons for the Demerger Transaction, to the "complication" of the cross-guarantees between Vital and the rest of the Group. They infer that he meant that the Demerger Transaction was intended to insulate Vital from the problems of the rest of the Group. I reject that contention. The sentence is taken out of context and the inference is unjustified in light of the evidence as a whole explaining the reasons for the Distribution. The claimants also rely on the fact that the full £6 million realised from the sale of the 30% interest in Vital was not loaned to the Group. That, however, is explained by the fact that the funding needed to address cash-flow difficulties of the Group, as at October 2007, was £3 million. The fact that, later on, when the financial position of the Group worsened, the Fieldings did not advance the remaining funds is irrelevant to their intentions at the time of the Distribution.

## E11. Relief from liability under s.1157

408. On the basis of the conclusions reached above, this issue does not arise. I will nevertheless deal with it in case this matter goes further, on the assumption that one or other of my conclusions is wrong.

409. The court has a broad discretion to grant relief (in whole or in part) from liability in proceedings against (among others) a director for negligence, default, breach of duty or breach of trust where it appears that the director acted honestly and reasonably and, having regard to all the circumstances, he ought fairly to be excused.

410. The claimants contend that this third limb of s.1157 cannot be satisfied in the present case because the defendants were themselves (albeit indirectly through their ownership of shares in BHUH) the recipients of the unlawful distribution.

411. In *Inn Spirit Ltd v Burns* [2002] 2 BCLC 780, the defendant directors (and ultimate shareholders of the company) caused the company to distribute £1.9 million (virtually its entire assets) to them. The company went into liquidation three months later. The defendants retained the whole of the £1.9 million, being anxious that every penny of company liability should be paid. It was common ground that the distribution was unlawful: the company did not have anything like sufficient distributable profits to justify the distribution. There was no question of the distribution being lawful by reference to the last annual accounts and no interim accounts were prepared. The company, in an action brought by its liquidator, sought summary judgment of a claim against the directors for misapplying the company's assets. The defendants relied on s.727 of the 1985 Act (the forerunner to s.1175 of the 2006 Act). Rimer J held that the defendants had a real, as opposed to fanciful, prospect of establishing at trial that they acted reasonably. He concluded, however, that there was no real prospect of them establishing that they "ought fairly to be excused" for their breach of duty: "…I cannot see that the court could or should excuse them from liability at the expense of creditors of the companies, and in my judgment it follows that it could and should order them to repay every penny of the £1.9m (and interest) necessary to enable the

companies to pay all creditors what would otherwise have been paid to them if the money had not been removed from ISL in the first place." He recognised that, on this basis, it may be that the defendants would be excused from making full repayment of the whole £1.9 million. Rather than granting summary judgment, he ordered an interim payment in a sum equal to a reasonable proportion of the likely final judgment amount, taking into account the possibility of a partial relief from liability under s.727.

412. In *Re Marini Ltd* [2004] BCC 172, the directors of the company caused it to pay an unlawful dividend. The directors relied on s.727 of the 1985 Act. HHJ Seymour QC found that they had acted honestly and reasonably, relying on the advice of accountants. Having been referred to *Inn Spirit v Burns*, however, the judge said:

> "However, like Rimer J I have the greatest difficulty in seeing that it is ever likely that 'in all the circumstances of the case' it is going to be right that a defaulting director 'ought fairly to be excused for the negligence, default, breach of duty or breach of trust', if the consequence of so doing will be to leave the director, at the expense of creditors, in enjoyment of benefits which he would never have received but for the default. However honestly the director acted, however much it may have appeared at the time of the act complained of that the only person who might be harmed by the act would be the director himself, it just is not fair, as it seems to me, that if it all goes wrong the guilty director benefits and the innocent creditors suffer. For this reason I decline to exercise my discretion under s.727 in favour of any of the respondents in relation to their respective liabilities for breach of s.263 in relation to the dividend. Had I been persuaded that that breach extended to the entirety of the dividend I should, however, have exercised my discretion in favour of the respondents so as to relieve them of liability for so much of the distribution as could lawfully have been paid at that time. Had they limited the distribution to the amount of profits then available for distribution they would not now have incurred any liability in respect of that act."

413. While I do not accept that the discretion in s.1157 is fettered such that the court can never relieve a director from liability in circumstances where he or she is the recipient of the unlawful dividend, even where the company subsequently goes into liquidation so that the retention of the dividend can be said to be at the expense of creditors, I nevertheless accept that the fact that a director received an unlawful dividend at the expense of creditors is a powerful factor against granting relief. Whether that factor is enough to preclude relief being granted will depend upon matters such as the causal link between the dividend and prejudice to creditors, the length of time between the dividend and the action being commenced and whether the director retains the benefit of the dividend.

414. Of particular relevance, therefore, is the extent to which the Distribution could lawfully have been made in the circumstances existing at the time (this being recognised as a potentially relevant factor by Robert Walker LJ in *Bairstow v Queens Moat Houses plc* [2002] BCC 91, at [36], and by HHJ Seymour in *Marini*).

415. The extent to which it would be appropriate to grant relief in this case depends on the extent to which, and the respects in which, my findings in relation to the unlawfulness of the Distribution and/or the liability of the defendants might be overturned.

416. I will first consider the position if the only respect in which the Distribution was found to be unlawful was because of the failure to recognise in the Interim Accounts a liability of £80,000 in respect of Addleshaw Goddard's costs. This is the only matter where I have concluded, in the event that the Distribution was unlawful, that Mr Fielding was at fault. I would in this instance nevertheless have been prepared to relieve Mr Fielding from liability under s.1157. In the first place, as I have concluded above, he acted honestly. Secondly, if this were the only respect in which the Distribution was rendered unlawful, then it amounted to a technicality which could readily have been cured by the simple expedient of procuring an increase in the dividend from K2 Glass in an amount less than £30,000. Even though I have concluded that Mr Fielding's failure to discover the amount of Addleshaw Goddard's costs was a failure to act as a reasonable director would have acted, I nevertheless would characterise his actions in procuring the Distribution to be made as reasonable, for the purposes of s.1157, in circumstances where, had the need to record the liability for legal costs been spotted, it could (and, I find, would) have been counterbalanced by a small increase in the dividend from K2 Glass. Finally, for the same reason (that the Distribution could in this way have lawfully been made) it would in my judgment be fair in all the circumstances to relieve him from liability.

417. On the other hand, at the opposite extreme, if it were to be found that the Distribution was unlawful because there were not, and could not have been created, sufficient distributable profits, and either that liability of the defendants is strict, or that they were at fault, then I would not have relieved them from liability under s.1157. The same is true if BHUK had been rendered insolvent as a result of the Distribution. In those circumstances, there would have been a direct causal link between the unlawful Distribution and prejudice to creditors. Accordingly, even if the defendants could be said to have acted reasonably, I would have found that in all the circumstances they should not be relieved from liability. Even though it is relevant to have regard to the delay in the bringing of the proceedings, that would not have been sufficient to outweigh the fact that the Distribution would have been at the expense of creditors given the size of the benefit received by them and the fact that, despite the passage of time since the Distribution, they still retain their interest in Vital. In this respect, I would have rejected the defendants' contention that the defendants ought to be excused because any recoveries made in this litigation will only enure to the benefit of creditors once the very substantial fees and expenses built up in the liquidation of BHUK have been satisfied. Whether or not there are grounds to challenge the quantum of those fees and expenses, I do not think that their existence provides a reason for granting relief from liability under s.1157 if, as appears to be the case, there are in fact unpaid creditors in the liquidation.

418. In relation to the intermediate possibilities, depending on which of my findings might be overturned, the task of considering whether relief under s.1157 might be given is at this stage too hypothetical an exercise to make it a sensible one to undertake.

## E12. Remedy/Quantum

### *Introduction*

419. It was common ground that, had I found the defendants liable for breach of duty in respect of the Distribution, compensation would be measured by the value of the shareholding in Vital as at the date of the Distribution.

420. There was a measure of agreement between the experts as to the valuation of Vital. They agreed upon the following definition of market value: "the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion."

421. They also agreed that in the case of a company such as Vital, either an earnings-based or DCF approach is appropriate. A valuation based on net assets would not, however, normally be appropriate.

422. While the experts agreed that evidence of valuations carried out by third parties at around the same time and offers made for, and acquisitions of, shares in Vital at the time are relevant indicators of value, they disagreed as to the usefulness of that evidence in the present case.

423. The claimants' expert, Mr Davidson, valued Vital as at the date of the Distribution:

i) On the basis of the acquisition by SSE of 30% of the shares in Vital for £6 million, at a range of £18-22 million;

ii) On a DCF basis, having regard only to the three-year forecasts contained in the May Business Review (see paragraph 44 above), at £23.25 million;

iii) On a DCF basis, having regard to the May Business Review and actual performance of Vital over the 10 years from 2008, at £20.4 million; and

iv) On an earnings basis, at a value of £22 million.

424. The defendants' expert, Ms Barker, values Vital as at the date of the Distribution:

i) On an earnings basis (assuming the inter-company receivables due to Vital were recoverable) at between £7 million and £9.4 million; and

ii) On an earnings basis (assuming the inter-company receivables due to Vital were irrecoverable) at between £3.7 million and £6.1 million.

425. Ms Barker did not undertake a valuation on a DCF basis, as she considered there were no reliable projections of cashflows on which to do so.

### *SSE Valuation*

426. SSE's acquisition of 30% of Vital is almost exactly contemporaneous with the date of the Distribution, the offer having been made in July and the acquisition having completed on 19 October 2007. Mr Davidson's view was that a transaction in the

company's own share capital would ordinarily determine the value of the company. Extrapolating from £6 million for a 30% stake, this would indicate a value of £20 million. In this case, however, since it is not known how SSE arrived at the price, it is impossible to know whether it represented a discount (on the basis of purchase of a minority stake) or a premium (reflecting a strategic purchase). Accordingly, Mr Davidson accepted that the price paid by SSE may not itself determine the value of the whole company. He considered, however, that a range of £18 million to £22 million (reflecting a 10% discount or 10% premium) is a reliable guide to the market value of Vital.

427. Ms Barker has not arrived at a valuation based on the SSE acquisition. While she agreed that it is a relevant reference point, she did not agree that it is a useful indicator, because it reflected a strategic purchase and because the directors considered the amount paid by SSE to be an over-value. Mr Beckett is reported to have informed the board of BHUK on 29 August 2007 that although you could "take extreme views on the valuation from the £20 million theoretical value by reference to the SSE valuation, however there was not a strategic purchaser at this point willing to purchase 100% of the business."

428. Ms Barker relied, in concluding that SSE was a special purchaser, on the fact that the offer contained conditions, including: pre-emption rights, requiring Vital's management to enter into service contracts, securing continuity of supply contracts, appointing a board member and complete separation from the Burnden Group. These matters would have decreased the level of risk associated with the transaction and would likely have increased the amount that SSE was willing to offer for a stake in the business.

429. In cross examination, Mr Davidson agreed that SSE was likely to be a special purchaser in that Vital had a special value to it because of advantages arising from ownership of a minority stake that would not be available to others. However, he considered that most of the matters relied on by Ms Barker as constituting valuable benefits would have had minor, if any, impact on the price SSE was willing to pay. As to the conditions contained in SSE's offer:

i) I agree with the claimants that since the pre-emption right gave SSE merely first refusal on the sale of other shares, but at market value, it would not have been perceived as particularly valuable.

ii) I also accept the claimants' submission that the right to have a director appointed to the board was typical in an acquisition of 30% of shares in a company, and while being of some value, would still have left SSE without either shareholder or board control.

iii) The claimants contend that the obligation that Vital's business be separated from that of the remainder of the Burnden Group was not something which pointed to SSE being a strategic purchaser, since it would have been an inherent consequence of any sale of 100%. I accept, however, Ms Barker's point that someone purchasing only 30% of the shares may well be prepared to pay a premium for obtaining an advantage which would otherwise only accrue on purchasing all the shares.

iv) I accept the claimants' submissions that the management tie-ins were typical in a transaction of this size and unlikely to be reflective of SSE's position as a special purchaser. They were relatively modest, being reflected in service contracts for Mr Fielding and Mr Whitelock which contained a 1-year notice period but also permitted each of them to be removed without notice on payment of a sum capped at around £100,000. While it is true that Mr and Mrs Fielding were subject to a non-compete covenant for a period of three years, there was no such restriction on any other member of management. I accept Mr Davidson's point that a non-compete covenant such as this was not unusual, and that a common method for ensuring continuity of active involvement on the part of those selling a business was by way of deferred consideration, but there was no such provision in this case.

v) Mr Davidson accepted that ensuring continuity of supply contracts would have provided a commercial benefit of some value to Vital. This, however, would have been important to any purchaser and does not in itself identify SSE as a special purchaser.

430. In addition to the specific conditions contained in SSE's offer letter, Ms Barker considered that there would have been special value to SSE in terms of the synergies and growth that it was looking to make in its own businesses.

431. In my judgment, the SSE acquisition price cannot be dismissed as easily as Ms Barker contends. SSE was a substantial and highly experienced operator in the field in which Vital operated. It undertook extensive due diligence. Its conclusion that £6 million was a fair price for 30% of the shares deserves to carry significant weight in seeking to arrive at a value of 100% of the shares. As I have noted, Mr Davidson does not suggest that it is possible simply to extrapolate from the price paid for 30% to the value of the whole shareholding, since he agrees that to some extent SSE was a special purchaser. While I accept that it is often appropriate to apply a discount for a minority interest, this is counterbalanced in this case in part by the conditions imposed by SSE and in part by the fact that SSE's strategy more generally was acquiring significant, but minority, stakes in other businesses. The key question is what, in all the circumstances, is the appropriate level of discount from the extrapolated value of £20 million. Mr Davidson has given some indication of this, by offering a range of 10% more or less than £20 million. Ms Barker has offered no opinion on this, as she dismisses reliance on the SSE acquisition altogether.

***DCF basis of valuation***

432. The experts are agreed that a DCF valuation is an appropriate method for valuing a company such as Vital. Mr Davidson's view is that a DCF valuation is usually considered to be the best methodology to apply to the valuation of a profitable trading business because it relies on company and market data and analytics in a way that an earnings approach does not.

433. In her first report, Ms Barker says that she was not instructed to carry out a DCF valuation. In her second report she said that, while she recognised the DCF approach can be an appropriate methodology for valuing a profitable business as a going concern, it was not appropriate to carry out such a valuation in the case of Vital

because there was insufficient, detailed, contemporaneously-prepared cashflow information to enable a reliable valuation to be prepared on this basis.

434. Mr Davidson used two sources of cashflow information: (1) profit and loss and cashflow forecasts for the years 2006/2007, 2007/2008, 2008/2009 and 2009/2010 contained in the May Business Review; and (2) Vital's actual results for the ten years 2008-2017.

435. Ms Barker's reasons for rejecting reliance on the forecasts contained in the May Business Review are that they were not prepared in the ordinary course of business but were prepared with a view to attracting external investment and, as such, were likely to reflect best-case scenarios. She also said that, routinely, forecasts for a five to ten-year period are relied on for a DCF valuation. While I accept that the only forecasts available are those contained within the May Business Review, which was a document prepared in order to attract investment, I do not accept that this is a reason for dismissing those forecasts. Although they are no longer available, the Group prepared cashflow forecasts for internal purposes on a regular basis. On occasion, at least, these were shared with Tenon (as is apparent from the documents disclosed recently by Tenon). It is clear that Mr Beckett as finance director had a close and open relationship with Tenon. It is unlikely that the forecasts annexed to the May Business Review would have differed materially, if at all, from those prepared for internal use. The forecasts would in any event be subject to detailed scrutiny by any potential purchaser, and if the assumptions on which they were based were unreasonable this would likely have been picked up, damaging the prospects of a sale. As to Ms Barker's second criticism, while Mr Davidson agrees that a longer period of future data is preferable, there will always be reservations about the reliability of cashflow projections too many years into the future.

436. Ms Barker's reason for rejecting reliance on Vital's actual results for 2008-2017 is that it is an impermissible use of hindsight. The information was not available to the directors at the time of the valuation. Moreover, the actual results reflected Vital's performance with the benefit of such synergies as came with SSE owning 30% of the shares. I accept these criticisms. Mr Davidson said that Ms Barker had misunderstood his reliance on the actual results, as all he is saying is that how the business actually turned out is as good a source of data for how the business was expected to turn out as any other set of actual or constructed data. I disagree. What happened subsequently is not evidence of what it was reasonable to anticipate at the time of the valuation. If there was no change in circumstances throughout the period of the actual results, then they might provide, at best, a limited sanity check in respect of the forecasts. I note, however, that Mr Davidson's DCF valuation, if based upon the actual results, is lower than his valuation if based on the forecasts alone. As such, the criticism of his reliance on actual results does not in practice assist the defendants.

437. While she has not undertaken her own DCF valuation, Ms Barker criticises further aspects of Mr Davidson's valuation.

438. First, Ms Barker notes that Mr Davidson has calculated his DCF valuation on the basis of the forecast operating profit (after tax) for each year as set out in the May Business Review. He has accordingly failed to make adjustments necessary in respect of depreciation, capital expenditure and changes in working capital requirements. Mr Davidson accepted in cross-examination that he had not taken these matters into

account. He said, however, that over the length of the period "these things even out, and that depreciation and capex will match each other" and that, in the absence of very detailed information, the amount of net profits was likely to be similar to the cashflows of the business. I accept, in part, Ms Barker's criticism in this respect, combined as it is with her point that there was insufficient information as to future performance to arrive at a reliable DCF valuation. I do not accept that it leads to the conclusion that no reliance can be placed on Mr Davidson's DCF valuation, however, only that it must be treated with caution.

439. Ms Barker also criticised elements of the discount rate (of 14.14%) adopted by Mr Davidson, namely: (1) the risk-free rate of return used by Mr Davidson (2.5%), contending that risk-free rates are derived from the yields for government bonds with long maturities as at the valuation date, and that as at the end of September 2007 the rate of return on medium-term government gilts was 4.99%; (2) the market risk premium used by Mr Davidson (6%), on the basis that, having reviewed DCF valuations carried out in the second half of 2007, the market risk premium that KPMG was using was 5%; (3) Mr Davidson added an additional risk premium of 3% to reflect a private equity investment, which Ms Barker thinks was not common practice and not appropriate since it was not a private equity transaction; and (4) Mr Davidson used the same company specific risk (3%) in relation both to the valuation based on the forecasts in the May Business Review and the forecast based on the actual results, noting that a valuer would have attributed a very different level of risk to the reliability of these different approaches. Only the third of these points was put to Mr Davidson in cross-examination (and, on that, Ms Barker did not proffer any alternative rate). On the other hand, Ms Barker's evidence on these points was not tested in cross-examination at all.

440. Ms Barker did not calculate the net effect of her alternative rates (and the removal of the additional private equity risk) on the valuation prepared by Mr Davidson. In aggregate, I calculate that they would have resulted in a smaller discount rate, which would in fact have *increased* the overall valuation.

441. In view of the absence of full information, the more limited than usual period covered by the cash-flow forecasts, the fact that Mr Davidson's figures do not include matters such as capital expenditure and depreciation (and there is insufficient information to form a view whether these would have balanced out over the ensuing years) and the fact that the cashflows envisaged substantial year-on-year increases in revenue and profits, as against the fluctuating historical profits, I conclude that while Mr Davidson's DCF valuation is a helpful piece of the picture, there are nevertheless good reasons to apply a not insignificant discount to his figure.

***Tenon Valuation***

442. In March 2007 Tenon corporate finance produced a valuation of Vital, at the request of Vital's board of directors and based on information provided by the company. This valued Vital on three bases, at:

    i) between £1.6 million and £2.7 million on an earnings basis, based on the simple average historic profit from 2004 to 2006 (£542,000);

ii) between £3.8 million and £6.4 million on an earnings basis, based on the average projected results for 2007 to 2008 (being £1.28 million); and

iii) £3.9 million on a net assets basis.

443. Tenon noted that the valuation report was prepared without knowledge of, or consideration given to, any future strategic plans or restructuring. They also noted that, as with any valuation, it provided only an indication of likely transaction values and that "the only sure method of valuation is to offer a business on the open market". Tenon had ignored the possibility that a strategic purchaser might emerge who would be prepared to pay a premium in order to acquire the business.

444. The lower end of the range of earnings-based valuations was, in each case, based on a price to earnings ratio ("p/e ratio") of 3, and the upper end of the range was based on a p/e ratio of 5. In arriving at these p/e ratios, the valuation report noted:

i) Given the absence of a marketplace for shares in unquoted companies, evaluation of a p/e ratio is essentially an informed guess;

ii) In Tenon's experience most quoted companies generally achieve multiples of between 3 and 8 in open market transactions;

iii) Certain factors indicated a higher p/e ratio: Vital's underlying business was cash generative; earnings were growing year on year (save for a sharp reduction in 2005); Vital had a wide customer base;

iv) On the other hand, certain factors indicated a lower p/e ratio: fluctuating levels of turnover and profitability; future levels of profitability were dependent on securing new projects and delivering the contractual terms of existing projects; the reduction in profitability in 2005; there was no evidence that investors were as yet placing a premium on the sector in which Vital operated; the lack of a loyal recurring customer base; and Vital's reliance on the technical expertise of its operational staff, unless a purchaser could be given confidence that they would be tied into the business moving forward;

v) The p/e ratios were arrived at having made adjustments for the fact that Vital was an unquoted company and that it was relatively small compared to quoted companies.

445. Mr Davidson criticised the Tenon valuation because it fell short of being a professional valuation, containing no data references or analytics. Moreover, the subject matter of any valuation is the future, not the past, since the buyer is purchasing the current expectation of future profits or cashflows, and it was important to identify the current profitability of the business and any underlying trend, even if that trend was not linear. Mr Davidson said that the Tenon valuation failed in these respects. He contended that Tenon's choice of p/e ratio was in conflict with publicly available information at the time, pointing out that the Private Company Price Index (PCPI) for the first quarter of 2007 was at a multiple of 14.8x, the Private Equity Price Index was at 17.6x, and the FT non-financials price index was at 15.8x.

446. In cross-examination, Mr Davidson suggested that the problem with the detailed factors set out in the Tenon report which influenced either a higher, or lower, p/e ratio was that he could not tell which were presented as "good" factors, and which were presented as "bad" factors. I reject that criticism because, although it is true that the factors are not listed separately as "good" or "bad" it is self-evident on reading this section of the report whether the factors, as applied to Vital, were believed to have either a positive or negative influence on the p/e ratio.

447. Ms Barker pointed out that by 2007 Tenon had already been advisors to the Group for some years, and that the report was prepared for the directors who knew the business intimately, so that there would have been no need for lengthy analysis of the business. Accordingly, it cannot be assumed that Tenon had not undertaken and taken account of matters beyond that which appears in the short report.

448. In relation to the figure for current (or maintainable) earnings (the multiplicand) Ms Barker agreed with the principle that the subject matter of a valuation is the future not the past, but said that historical performance is also relevant as an indicator of future performance. I note, however, that the upper end of the Tenon range of valuations was based on a multiplicand of £1.28 million which is close to that which Mr Davidson arrived at in his own earnings-based calculation, and significantly less than the multiplicand adopted by Ms Barker in her own valuation (£2.4 million).

449. Ms Barker did not comment, in her reply report, on Mr Davidson's criticism that Tenon's choice of p/e ratio was inconsistent with the current PCPI. When addressing Mr Davidson's own earnings-based valuation, she accepted that the PCPI is a useful reference point, although as stated in the index itself it is an average, not an absolute measure, "as there are many other factors that can have an impact on value." Ms Barker's defence of the Tenon valuation was based principally on the fact that she had not had access to Tenon's files, so could not second-guess what they had done, that they were experienced and had knowledge of the business, and that the directors did not appear to think that their report had understated Vital's value. I place little reliance on what the directors thought of Tenon's valuation since the directors were not valuation experts. Moreover, the absence of Tenon's files, and lack of evidence from Tenon itself, cuts both ways. While it makes it difficult to criticise their methodology, and although I accept that a valuation carried out roughly contemporaneously with the valuation date is deserving of weight, the lack of such evidence means that the results need to be treated with caution. So far as the appropriate p/e ratio is concerned, the main thrust of Mr Davidson's criticism is that the starting point in the Tenon report – that "most unquoted companies" achieve multiples of between 3 and 8 – is on the face of it inconsistent with the PCPI from the time. That is a point that Ms Barker has not convincingly answered.

450. In my judgment, the following factors point to the Tenon valuation having been a significant undervalue. First, as Tenon noted, the best evidence of market value is what someone is willing to pay, and the SSE acquisition for 30% of the shares at an amount roughly comparable with the top of the range of values identified by Tenon for 100% of the shares indicates in itself that Tenon's estimate was clearly too low. Second, I find that the starting point for the p/e ratio was too low, given the uncontested evidence from Mr Davidson as to the multiples being achieved in the marketplace according to the PCPI at the time. Third, there was too little focus in the Tenon valuation on the trend of earnings, and the impact that had on future prospects,

in particular taking into account the projections for 2007 (the valuation being carried out three-quarters of the way through that year). Accordingly, I consider that the appropriate range of valuations as at the date of the Distribution is significantly higher than the Tenon valuation.

***Earnings-based valuation***

451. There are two central elements in an earnings-based valuation: the multiplicand, being the current (or estimated maintainable) earnings; and the multiplier, being the p/e ratio.

***Multiplicand***

452. Mr Davidson calculated a pre-tax profitability multiplicand of £1.2 million. In her first report, Ms Barker arrived at a figure for maintainable earnings of £2.4 million. In her second report, however, she appears to have abandoned her own maintainable earnings figure and worked on the basis of Mr Davidson's figure, albeit making one significant complaint, namely that it failed to take into account ongoing annual financing costs, which Ms Barker calculated as £237,000.

453. In cross-examination Mr Davidson accepted that he had failed to take these into account but did not agree that the annual financing costs were £237,000. The only basis for this figure advanced by Ms Barker was that it was indicated by the financial statements for Vital for the years ended 30 June 2007 and 30 June 2008. In fact, in Vital's accounts for the year ended 30 June 2007 they were identified as £171,000. The figure of £237,000 comes from the accounts for 30 June 2008. The latter, however, postdate the Distribution by 10 months and accordingly would not have been available at the valuation date. The evidence therefore supports a reduction in the multiplicand but only in the sum of £171,000, i.e. to a figure of £1.029 million.

454. In closing, both parties appeared to be content to proceed on the basis of Mr Davidson's multiplicand (subject only to the error in respect of financing costs). The defendants' closing submissions focused solely on Mr Davidson's figure, and the claimants simply noted that there was relatively little difference between the parties in respect of the multiplicand. Accordingly, I will proceed on the basis that the appropriate multiplicand is £1.029 million.

***Multiplier***

455. Mr Davidson selected a multiplier of 18.3x. He arrived at this by taking the p/e ratio of 21.9x for SSE. There was no source attributed to this figure in his report, but he subsequently disclosed that it came from "Risk Measurement Service" from March 2008. Ms Barker produced reports from Deutsche Bank and Credit Suisse, both dated November 2007, which presented a p/e ratio for SSE for 2007/8 between 14.1x and 16.8x.

456. It was put to Mr Davidson that SSE, having a highly diverse business, with net assets of £2.9 billion and turnover of £15.2 billion was simply not comparable with Vital, having no diversity, with a smaller turnover by a factor of 1000 and net assets of £1 million. Mr Davidson's response was to say that they were "comparable in the sense that there is an expectation of the future in this industry which we can see from SSE's

PE ratio". In fact, the document he relied on classified SSE as being in the electricity sector and the industry weighted average p/e ratio for that sector was 7.0x. In light of this evidence, not only do I find the figure used by Mr Davidson for SSE's p/e ratio to be inaccurate as an approximation as at the date of the Distribution, but I do not regard SSE's p/e ratio to be a reliable comparator in any event.

457. There was also a dispute between the experts as to the appropriate discount to be made (from SSE's p/e ratio) to reflect the fact that SSE is a public company. Ms Barker said that it should be 35%, because that was the extent of the difference between PCPI in relation to companies in the natural resources sector (12.5x) and the relevant multiple for FTSE companies (19.2x) in the same sector at the relevant time. Mr Davidson, on the other hand, discounted SSE's price by dividing the PCPI multiple by the multiple in the Private Equity Price Index. When tested on why he had done it this way, he said that was because it produced a larger discount (and was thus a more cautious approach) than dividing the PCPI by the FTSE multiple. Given that I have rejected the reliance on SSE's p/e ratio in any case, it is unnecessary to resolve this difference, although it seems to me that on balance Ms Barker's approach appears to be more logical: if the difference between the average multiples in the market place for public and private companies was 35%, then that would seem to be a reasonable starting point for deriving the p/e ratio of a private company if all one has is the actual p/e ratio of an appropriately comparable public company.

458. For her part, Ms Barker selected a multiplier of between 3 and 4. Her starting point was the multiplier used by Tenon in its valuation of March 2007, of between 1.7x and 2.9x. She then took account of various risk factors, including that by October 2007 Vital appeared to be well-positioned to take advantage of various opportunities, but noting the directors' view that Vital's opportunities were limited while it remained part of the Burnden Group and its heavy reliance on Mr Fielding and Mr Whitelock. On the basis of these, she increased the p/e ratio slightly above that which Tenon had used.

459. I have already concluded that the Tenon valuation was an under-value, in large part because of the unreliability of the assumption that companies in the market were achieving multiples of between 3x and 8x. It follows that I reject the Tenon valuation as a reliable starting point for determining an appropriate p/e ratio for Vital as at the date of the Distribution.

460. Other evidence that was noted, but rejected, by Ms Barker included the multiplier implicit in the SSE deal, which she calculated as 8.3x. She discounted this, however, because it was a strategic investment and because Mr Fielding and Mr Whitelock considered the amount paid to be an overvalue. Mr Davidson points out that her calculation was based on her own assessment of maintainable earnings (£2.4 million). On the basis of Mr Davidson's figure (which the defendants, as noted above, appear content to rely upon, adjusted for finance costs) of £1.029 million, the implicit p/e ratio is closer to 19x.

461. Ms Barker also referred to multiples available for two comparable companies from October 2007. The p/e ratio for one (Meier Tobler Group AG) was 4.5x, and for the other (Rafako SA) was 25.9x. She rejected these as a reliable guide because the range was too wide and because these companies were large public companies operating in a more diverse range of markets than Vital. Mr Davidson looked at the financial

statements for the two companies and noted that Meier was experiencing a contraction in profits, while Rafako had demonstrated huge growth in the 4-5 years from 2007. He concluded that since Vital was demonstrating year on year growth it would attract a p/e ratio weighted towards the higher of the two ratios.

462. As I have noted above, Mr Davidson relied upon the multiples achieved in the market for private companies as evidenced by the PCPI, in rejecting the assertion in the Tenon valuation report that companies were achieving multiples of between 3 and 8 as at March 2007. PCPI multiples for the 3rd and 4th quarter of 2007 were, respectively, 13.4x and 12.9x.

463. For the above reasons, there are flaws in the approach of each of Mr Davidson and Ms Barker in seeking to identify the appropriate p/e ratio. The one thing they agreed upon is that identifying an appropriate p/e ratio is a matter of judgment. Identifying the "correct" p/e ratio at this distance of time with incomplete information, and with such a large divergence of opinion between the experts, is particularly challenging.

464. Doing the best I can with the information available, I consider that the matters in the paragraphs above point towards a p/e ratio towards the higher end of the range between Ms Barker and Mr Davidson. In my judgment, the appropriate figure is between 12x and 15x.

***Offer from Inexus***

465. The only other offer received for an interest in Vital was that made by Inexus Group (Holdings) Ltd on 21 June 2007. This was described in evidence by Mr Whitelock as an offer of £3m for a 30% stake. In fact, from the limited email correspondence that is available in relation to this offer, it appears that there was initial consideration being given by Inexus to acquiring 100% of the shares (although it is unclear at what price), because Mr Whitelock emailed Mr Jenkins of Inexus on 12 June 2007 asking what his position would be if Vital concluded it wished to dispose of only 30% of the shares. Mr Jenkins' response was to ask Mr Whitelock to "explore a scenario … based on 100% of the 30% upfront (i.e. £3M upfront) for a 30% stake".

466. It is very difficult to place reliance on this offer, given the absence of any further details. For example, the £3 million was described as upfront payment, implying that the total price was to be more than this. Moreover, no firm offer was ever received, and Inexus does not appear to have carried out any due diligence.

***Further discounts advocated by Ms Barker***

467. Ms Barker contends that a discount should be applied to the valuation of Vital to take account of the assumption (if the claimants succeed in establishing that the defendants acted in breach of duty) that BHUK was not only insolvent but in a formal insolvency process. She contends that in that event, it was more likely that a forced sale would have occurred, leading to a significant reduction in price. I reject this contention because it is common ground between the parties that BHUK was solvent at the time of the Distribution. In the counterfactual (in which the Distribution does not take place) therefore, there is no reason to assume that BHUK was insolvent, let alone that it would have been placed in a formal insolvency process.

468. Ms Barker also contends that a discount should be applied to reflect the risk that Mr Fielding and Mr Whitelock might not continue in the business. In her first report she provided "illustrative calculations" for the purposes of which she assumed that, in that event, maintainable earnings would be reduced by 50% and the multiple would also be discounted by 50%. She provided no reasoned basis for these levels of discount. In cross-examination she said that they were just illustrative calculations rather than her firm opinion. I reject them, both because she provided no reasoned basis for them and because to the extent that there was a risk of Mr Fielding or Mr Whitelock not remaining with the business that was something which she had already factored into her earnings-based valuation and which I in any event take into account (see below) in arriving at a valuation for Vital.

***Conclusion***

469. Taking into account all of the above evidence, my conclusions are as follows.

470. First, the Tenon valuation is not an appropriate starting point, and represented a significant undervalue of Vital. Nevertheless, the matters identified in the Tenon report relevant to the exercise of judgment as to where to pitch the p/e ratio deserve serious consideration, being made by persons who were both familiar with Vital's circumstances and who were writing largely contemporaneously.

471. Second, the consideration of £6 million paid by SSE for 30% of the shares in Vital is a more compelling starting point, although I accept that as SSE was a strategic purchaser it was likely willing to pay more for 30% of the shares than it would (pro rata) for 100%, and a discount should be applied to the implied value of £20 million for the whole company.

472. Third, while the DCF valuation carried out by Mr Davidson is a helpful indicator of value, I nevertheless conclude that a significant discount from his valuation is justified, on the basis of the limitations identified above.

473. Fourth, an earnings-based valuation (which is the only type of valuation both experts have attempted to carry out), based on a multiplicand of £1.029 million and a multiplier in the range of 12x to 15x as I have indicated above, produces an overall valuation between £12.348 million and £15.435 million. A valuation towards the top end of this range would produce a discount: (1) of 25% on the valuation extrapolated from the SSE acquisition; and (2) of 35% on Mr Davidson's DCF valuation based on the May Business Review forecasts alone. Taking into account in particular the limitations on those forecasts I have identified above, and the discount justified by the importance of Mr Fielding and Mr Whitelock to the business, I regard these as reasonable discounts.

474. Accordingly, I conclude that the value of Vital as at the date of the Distribution was £15 million.

# F. The Grant of Security

## F1. The transaction in outline

475. Mr and Mrs Fielding loaned BHUK £1 million pursuant to a loan agreement dated 6 December 2004. Various subsidiaries, including K2 Con, Vital, K2 Glass and TBG were guarantors. By clause 3, BHUK and all the guarantors agreed to grant mortgage debentures in favour of the Fieldings. The mortgage debenture executed by BHUK was dated 23 December 2004. By clause 1, BHUK covenanted to pay to the Fieldings all sums which may now or at any time thereafter become due and owing under the loan agreement. While this was an "all monies" charge, therefore, it related to sums due under the loan agreement.

476. Over the following years, the Fieldings advanced further sums to one or other of the companies in the Group. In a letter dated 25 January 2006 from Mr Fielding to BHUK, Mr Fielding confirmed an agreement to provide a further loan of £1 million to BHUK "under the terms of my loan agreement dated 6th December 2004".

477. There is in evidence a draft of a board minute dated 23 October 2006 attended by Mr Whitelock and Mr Beckett (the Fieldings having provided apologies by reason of a conflict of interest). The draft minutes state that the meeting had been called to consider a letter from Mr Fielding dated 17 October 2006 asking the board to provide the security intended in the letters of 25 January 2006 and 17 July 2006 "or to repay the loans". The letters of 17 July and 17 October 2006 are not in evidence. The draft minutes, however, indicate that in the letter of 17 July 2006 Mr Fielding referred to his letter of 25 January and "confirmed the intention to loan a further £0.35 million to the company."

478. It is also apparent from the draft minutes that Mr Fielding had understood that the further lending by him, since December 2004, had been on the terms of the original loan agreement, and was therefore covered by the original debenture, but that Mr Whitelock and/or Mr Beckett did not share that view. Mr Fielding had expressed surprise at this in his letter of 17 October 2006. The draft minutes record Mr Beckett and Mr Whitelock agreeing, nevertheless, that it had been the board's intention that the further loans were to be incorporated into the original loan agreement and subject to the original security. It was recognised, however, that this was not the case, and that a further loan agreement and grant of security would be necessary. Mr Beckett raised the fact that the current financial position of the company would need to be considered before granting further security, as cashflow over the winter months was "significantly adverse". There followed (according to the draft minutes) a discussion of the outlook for the Group, the result of which was that the directors were satisfied that "the process of ratifying the inclusion of the loans in the original loan account should be completed". It was noted that the board were "obliged to honour the intent of the agreement and ensure that the Loans are properly protected by the original Loan Agreement and Debenture" and that "the best interests of all creditors had been served by the acceptance of the Loans and would continue to be served by the continuance of the Loans." The reference to "continuance" of the loans is explained by the fact that it was necessary to extend the term of the original loan, which expired on 6 December 2006.

479. On 23 November 2006, Mr Beckett wrote to Mr Fielding to inform him that the board had, at its meeting on 23 October 2006, concluded that the original loan agreement should be amended to reflect the new loans: "we therefore propose signing a new loan agreement and debenture incorporating the new loans, on the same terms as the 6th December 2004 agreement, and for a period of two years to the 6th December 2008".

480. Hill Dickinson, solicitors, were instructed by BHUK in respect of the drafting of the documentation for the loan and security. Patrick McKeown, an associate at that firm, commented on the draft documentation in an email dated 20 December 2006. Among other things, he noted that "I believe this loan is to document the monies that have already been loaned to the Company rather than new monies". He recommended, in that event, that clause 2.2 be removed. The draft to which he was referring is not in evidence, although clause 2.2 of the executed loan agreement is in terms that appears to be referring to new lending (referring to the loan being made available for drawdown in one lump sum immediately following execution of the agreement). I have seen no evidence to explain why that clause was left in. Mr McKeown's email was, however, forwarded by Mr Beckett to Kate Matthewson, an associate at Addleshaw Goddard, and neither she nor Mr Beckett commented adversely on Mr McKeown's understanding that the monies had already been advanced. However, I also note that between October 2006 and June 2007 Mr Fielding did advance further money to the Group. An email from Mr Martin to Beckett of 24 May 2007 refers for example to Mr Fielding having "put £460k into Holdings at Christmas". By June 2007 the Fieldings' lending to the Group stood at just over £4.6 million.

481. There was a delay in finalising the documentation. It appears from emails in late March and early April (between Mr Beckett and Addleshaw Goddard) that this was due in part at least to delays in dealing with the other holders of security over assets in the various companies which were to grant security to the Fieldings.

482. Pro forma minutes were prepared for the boards of BHUK and several subsidiaries that were to enter into guarantees and debentures. The document headed "any other business" dated 22 June 2007 circulated by Mr Beckett referred to the intention to table the new loan agreement and debentures, and drew to the directors' notice the need for them to assess whether this was in the interests of the business, and to assess whether each company was solvent. He noted that as this was dependent upon continuing support from Vital, a signed undertaking of continued support from Vital had been obtained.

483. The board minutes are each in substantially the same terms, except that the identity of those present changes dependent on the particular company. They record as follows:

    i) Under the heading "Business of the Meeting" they stated that the Fieldings "had agreed, subject to receiving satisfactory security from [BHUK and its subsidiaries] to lend £4,640,000 to [BHUK] to assist [BHUK] with ongoing working capital needs."

    ii) The purpose of the meeting was stated to be to consider and if thought fit authorise the company to accept the loan and provide a guarantee and a debenture in support of the "additional funding" being granted to BHUK;

iii) The loan and debenture were presented to the meeting;

iv) After due consideration, the board confirmed its "full understanding of the effect and implications for the Company of entering into the Documents and unanimously expressed the opinion that … (a) there would be significant commercial benefit to the Company in its entering into the documents, utilising the facilities and granting the guarantees and security therein contained … and (d) after having taken account of the Company's internal financial information, the Company will be solvent at the time of, and after, the execution of the Documents, it will be able to continue to trade and to pay its debts as they fall due."

484. The minutes for the meeting of the board of BHUK record Mr Whitelock (as chair) and Mr Beckett and Mr Kavanagh as being present.

485. The loan agreement provided as follows:

i) In the recitals, it was noted that the Fieldings had agreed to lend and BHUK had agreed to borrow £4.64 million and that the loan was to be applied for the benefit of BHUK and the guarantors (being various of its subsidiaries);

ii) BHUK "shall borrow" the loan, which shall be available for drawdown in one lump sum;

iii) Events of default included BHUK or a guarantor being unable to pay its debts as they fall due, or entering into an arrangement with one or more of its creditors to reschedule any indebtedness.

486. Neither Mr nor Mrs Fielding were party to the decision to effect the Grant of Security. The claimants' pleaded attack on it is threefold: first, that no authority (or no effective authority) was ever given by BHUK for the Grant of Security because the board minutes of 27 June 2007 purported to authorise the entry into a loan agreement and debentures for *new* lending whereas all of the money had already been advanced; second, even if the other directors knew that the loan and debentures related to existing lending, then they breached their duty in effecting the Grant of Security because there was no benefit to BHUK, and the defendants knew of this; and third, the Grant of Security constituted a transaction for no consideration, or at an undervalue, and was entered into for the purpose of putting assets beyond the reach of creditors, within s.423 of the 1986 Act.

## F2. No effective authority?

487. I reject the contention that the directors of BHUK did not know that the Fieldings had already advanced the funds which were the subject matter of the new loan agreement. It is clear, from the discussions which the documents I have referred to above indicate took place in and after October 2006, that the directors knew full well that the purpose of the new loan agreement, guarantees and debentures was to fulfil the intention that the further loans already advanced by the Fieldings since December 2004 should benefit from security in the same way as the loan advanced pursuant to the loan agreement of 6 December 2004.

488. Although at one point the claimants appeared to be arguing that no meeting of the directors of BHUK took place at all on 27 June 2006, what was submitted in closing was that there was no *effective* meeting, but just a "signing ceremony" at which the directors did not give any consideration to the matters contained in the pro forma minutes.

489. The claimants point to those aspects of the minutes and the loan agreement that suggested that new lending was involved, and contend that the directors simply cannot have given any consideration to those documents because if they had, they would have noticed that they were wrong.

490. So far as the minutes are concerned, I do not accept that they are inconsistent with the fact that there was to be no new lending. The reference to the Fieldings having agreed "to lend" £4.64 million, while not telling the whole story, is consistent with them having agreed to enter into a new facility, for a further two-year term, for that amount. Similarly, the reference to the company having agreed to "accept" the loan, is not inconsistent with it having agreed to enter into a new facility agreement. Under the heading "commercial benefit" the references are (accurately) to the benefit of "entering into the Documents" and, in one case, to the benefit in "utilising the facilities", a phrase which might be understood as referring to the continuation of existing lending.

491. So far as the loan agreement itself is concerned, while the language can again be criticised for not providing the full picture, I do not find the reference in the recitals to the agreement "to lend" and "to borrow" necessarily inconsistent with what was happening, given that it was a new facility agreement for a new term. I accept that the reference in paragraph 2.2 to the draw-down taking place in one lump sum following execution of the agreement is inconsistent with the fact that the lending had already been drawn down. As I have noted above, this was an inconsistency expressly referred to in an email from Hill Dickinson to Mr Beckett, forward to Addleshaw Goddard in January 2007. There is no explanation why the clause remained in the agreement, but the fact that it did remain is not sufficient reason, in my judgment, to conclude that the directors attending on 27 June 2007 did not determine at that meeting to enter into security in respect of amounts already advanced by the Fieldings.

492. Not surprisingly, Mr Whitelock and Mr Beckett had no independent memory of events in June 2007. For the above reasons, however, I am satisfied that they approved the Grant of Security at the meeting on 27 June 2007 fully intending that it be security for advances already made. They were aware, prior to the meeting, that its purpose was to approve the Grant of Security (1) having already resolved in October 2006 to do so and (2) having been informed by Mr Beckett on 22 June 2007 that the documentation would be tabled for approval at the meetings of the various companies on 27 June. As I have indicated above, in relation to the board minutes in relation to the Distribution, I find nothing suspicious in the fact that pro forma minutes were drafted by lawyers for the purpose of ensuring that the matters which formally needed to be considered were covered.

## F3. No commercial benefit?

493. As at June 2007 the lending from the Fieldings was technically on demand, the term of the loan agreement dated 6 December 2004 having expired (and there being no term attached to the subsequent lending unless, on the basis that Mr Fielding had intended it to be made "under" the earlier loan agreement, it was subject to the same term, in which case it would have been covered by the existing security).

494. There was, therefore, a commercial benefit to BHUK and the other companies in the Group in the Fieldings agreeing to enter into a new facility agreement for a further two-year term. There can be no doubt that the Group benefitted from the continued lending: given the cash flow difficulties faced by the Group it would have been disastrous for it had the Fieldings required immediate repayment.

495. The claimants contend, however, that this benefit was illusory since (1) there was no realistic chance of the Fieldings calling in their loans and (2) even under the new agreement, all of the lending was immediately due and payable because there was an event of default from the outset.

496. As to the first point, it is difficult at this distance to test the counter-factual, namely what would have happened if the independent directors had refused to authorise the Grant of Security. In particular, the decision to do so having been taken back in October 2006, it was simply not an issue that arose in the months that elapsed between then and the execution of the documents.

497. I accept that as majority owners of the Group, and having replaced earlier bank lending with lending from them, it was in the Fieldings' interests to continue supporting the Group. It does not follow from that, however, that had the independent directors turned around and refused to sanction the Grant of Security, the Fieldings would have continued to provide that support. It is important in this context to note that the original lending was on a secured basis, and that Mr Fielding had believed until sometime shortly before October 2006 that the subsequent lending was secured on the same basis. Moreover, as the draft minutes of the meeting on 23 October 2006 indicate, Mr Fielding had then asked for the loans to be repaid if no security was to be granted, and the directors appreciated that the intention all along had been that the lending was secured, even if the documentation had not achieved that. In these circumstances, I do not accept that if the directors had refused to sanction the Grant of Security Mr Fielding would have simply agreed to enter into the new loan, nor that Mrs Fielding would have lent a further £3 million shortly afterwards, at least without taking some other steps to protect their interests.

498. Accordingly, in my judgment, it was to the benefit of BHUK and the Group to enter into the new facility agreement and authorise the Grant of Security.

499. As to the second point, it is true that K2 Con's insolvency, and its negotiations with HMRC to reschedule its VAT obligations, meant that there was an event of default under the new loan agreement from the outset. I do not regard that, however, as having negated the commercial benefit to BHUK. Given that the event of default existed (to the knowledge of all parties) at the point of entering into the loan agreement, there would have been a reasonable argument that in agreeing to the loan in such circumstances, the Fieldings had waived the right to rely on it. In any event,

they did not do so, but with the benefit of the security not only treated the lending as committed for a further two years but advanced substantial further funds to the benefit of BHUK.

500. In light of the above conclusions, the question whether the defendants were aware that the Grant of Security had been authorised by the independent directors in breach of their duty does not arise.

## F4. S.423 of the 1986 Act

501. The claimants contend that the Grant of Security was a transaction entered into by BHUK for no consideration, within s.423(1)(a), or for consideration the value of which, in money or money's worth, was significantly less than the value of the consideration provided by BHUK, within s. 423(1)(c).

502. To fall within s.423(1)(a) the transaction must be entered into for "no" consideration. It follows from my conclusion on the second issue (commercial benefit) that there was at least some consideration for the Grant of Security.

503. To fall within s.423(1)(c), a comparison must be made between the value obtained by the company, and the value of consideration provided by the company, with both values being measurable in money or money's worth, and with both being considered from the company's point of view: *Re M C Bacon Ltd* [1990] BCC 78, per Millett J at p.92D-E. In that case (which concerned s.238 of the 1986 Act, where the relevant language is identical), Millett J held that in granting a debenture for existing indebtedness the company parted with nothing of value: "By charging its assets the company appropriates them to meet the liabilities due to the secured creditor and adversely affects the rights of other creditors in the event of insolvency. But it does not deplete or diminish their value. It retains the right to redeem and the right to sell or remortgage the charged assets. All it loses is the ability to apply the proceeds otherwise than in satisfaction of the secured debt. That is not something capable of valuation in monetary terms and is not customarily disposed of for value." (see p.92E-G).

504. The same is true here. Considered from the point of view of BHUK, the grant of security involved no transfer of value from BHUK. If a company uses an asset worth £100 to repay a debt of £100, there is no question of the transaction being at an undervalue. From the company's perspective the value received equals the value given. It may well be that, looking at it solely from the creditor's point of view, the debt had a value less than £100 because of the company was unable to pay the full amount, so it received more than it gave. But that is irrelevant as value is to be assessed from the point of view of the company. The company can be in no worse position where, instead of using an asset worth £100 to repay a debt of £100, it appropriates an asset of that value to the debt by way of security. Where the value of the asset appropriated by way of security is greater than the value of the debt, there is no parting with that excess value, since (as Millett J held) all that the company has lost is the ability to apply the proceeds of that asset otherwise than in satisfaction of the secured debt (always subject to its ability to redeem the security by paying the debt) and that is not something capable of valuation in monetary terms.

505. The claimants rely on *obiter* comments of Arden LJ in *Hill v Spread Trustees* [2007] 1 WLR 2404. In that case, it was found that there was no consideration given to the bankrupt for the grant of security by him. It was therefore unnecessary to consider whether the transaction fell within s.423(1)(c). At [138], however, Arden LJ addressed an argument advanced on behalf of the bankrupt that as a matter of law the grant of security involved no diminution in the value of the bankrupt's assets and said: "I would provisionally not have accepted the argument that the grant of security in this case did not involve the disposition of any property right in favour of the trustees." She considered that "there seems to be no reason why the value of the right to have recourse to the security and to take priority over other creditors, which the debtor creates by granting the security, should be left out of account." In my judgment, however, Millett J, in *M C Bacon*, provided a reason why that value should be left out of account, namely that it has a value only from the point of view of the creditor, whereas the section requires value given and received to be viewed from the company's point of view. In any event, I should follow the decision of Millett J on this point unless I thought it was plainly wrong, which I do not.

506. For these reasons, I conclude that the Grant of Security did not fall within s.423(1)(a) or (c).

507. In those circumstances it is unnecessary to consider whether the Grant of Security was entered into for the purpose of putting assets beyond the reach of creditors. I find, in any event, that it was not. The purpose had to be that of the independent directors of BHUK, and it was not put to either Mr Whitelock or Mr Beckett that they entered into the transaction for that purpose. In my judgment the evidence recited above, relating to the lead up to the Grant of Security from October 2006 onwards, demonstrates that their purpose in entering into the Grant of Security was, in part, to honour the intent of the existing agreement that all lending from the Fieldings was on a secured basis and, in part, to benefit BHUK and the Group by ensuring continued support from the Fieldings.

## F5. Could the Grant of Security be ratified by the shareholders?

508. Given the conclusions reached above, this issue does not arise. I merely note that if those conclusions are wrong, and it were instead to be found that there was no fully informed consent by Mr Beckett and Mr Whitelock to the Grant of Security in their capacity as directors, then the defendants could not rely on the *Duomatic* principle, since this equally depends on fully informed consent, this time of all the shareholders, which included Mr Beckett and Mr Whitelock.

## F6. Is the claim time-barred?

509. The claimants accept (on the basis of *Hill v Spread Trustee Co Ltd* [2007] 1 WLR 2404, per Arden LJ at [126]-[128]) that a claim under s.423 of the 1986 Act is subject to a limitation period under either s.8(1) or s.9(1) of the Limitation Act 1980 and that time began to run on the appointment of the administrators to BHUK on 2 October 2008.

510. Section 8(1) of the Limitation Act 1980 provides a twelve-year limitation period for an action on a specialty. By s.8(2), however, that is subject to any shorter period of limitation prescribed by any other part of the Act. By s.9(1), a six-year limitation

period is prescribed for a claim to recover a sum of money by virtue of an enactment. The Grant of Security claim was commenced on 20 January 2017, the date it was introduced by amendment, and is therefore time-barred if it falls within s.9(1).

511. In *In re Priory Garage (Walthamstow) Ltd* [2001] BPIR 144 it was held that an action under s.238 of the 1986 Act (a transaction at an undervalue) will come within s.9(1) if it can fairly be said that the substance or the essential nature of the action is to "recover a sum recoverable by virtue of" that section. John Randall QC, sitting as a deputy judge of the Chancery Division, said: "One example of a case caught by s.9(1) is where the transaction to be set aside is a simple payment of a sum of money. Another might be where the only substantive relief available to the applicant is an order for the payment of money, such as where s.241(2) precludes the setting aside of the transaction." It is necessary to see what is the substance or essential nature of the relief "truly sought by the applicant in the particular case before it".

512. The parties accepted, in my view correctly, that the same principles apply to a claim under s.423. The claimants contend that the essential nature of their claim is to set aside the Grant of Security. They accept, however, that the only substantive relief claimed is the payment of a sum of money. The assets that were subject to the charge have long gone so that the only relief available is the payment of a sum of money. In those circumstances, had it been necessary to determine the point, I would have concluded that the claim is statute barred.

# G. Conclusion

513. For the above reasons, I dismiss the claimants' claims.