Neutral Citation Number: [2019] EWHC 573 (Ch)

Case No: CR-2017-008836

IN THE HIGH COURT OF JUSTICE

BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES

INSOLVENCY AND COMPANIES LIST (ChD)

The Royal Courts of Justice
Rolls Building
Fetter Lane
London EC4A INL

Date: 13/03/2019

Before :

MISS AMANDA TIPPLES QC

- -

Between :

MICHAEL ROUTLEDGE	**Petitioner**
- and -	
(1) RICHARD JAMES SKERRITT **(2) CATHERINE YVETTE GABRIELLE SKERRITT** **(3) SKERRITT CONSULTANTS LIMITED**	**Respondents**

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Mr Edward Davies QC (instructed by Coffin Mew LLP) for the Petitioner
Mr Andrew Thompson QC (instructed by Herbert Smith Freehills LLP) for the First and Second Respondents

Hearing dates: 14, 15, 16 and 17 January 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

Miss Amanda Tipples QC :

INTRODUCTION

1. Skerritt Consultants Limited (Company No. 04129116; "**the Company**") was founded by Mr Richard Skerritt ("**Mr Skerritt**") in December 2000. It carries on business providing financial services, particularly independent financial advice and wealth management services. The Company's articles of association incorporate the regulations contained in Table A in the Schedule to the Companies (Tables A to F) Regulations 1985 as amended, subject to certain additions, modifications and exclusions.

2. The Company's business has grown over the years through the acquisition of a number of other IFA businesses and in January 2019 it had £960 million of funds under its management. The Company employs just under 40 staff, and has seven independent financial advisers ("**IFAs**") associated with it.

3. The directors of the Company are Mr Skerritt, and his ex-wife Mrs Catherine Skerritt ("**Mrs Skerritt**") and Ms Karen McGrath, who was appointed in March 2014, in place of a Mr Mark Cardy. Mr Cardy and Ms McGrath are chartered financial planners, and were appointed as directors of the Company in order to fulfil its requirements for chartered status. Mr Cardy was appointed as a director in 2011. Neither Mr Cardy nor Ms McGrath attended any board meetings to which the issues in this case relate.

4. I shall refer to Mr and Mrs Skerritt together as "**the Respondents**" in this judgment.

5. Mr Michael Routledge ("**Mr Routledge**") joined the business in around May 2002. He did so as a self-employed IFA, and worked for the Company on a commission basis.

6. The Company's accountants are, and have been for many years, Wilson Sandford Ltd, formerly Wilson Sandford & Co ("**Wilson Sandford**"). In addition to preparing the Company's accounts, they are also responsible for preparing minutes of Company meetings and advising in relation to the Company's capital adequacy requirements (to ensure the Company is not in breach of any regulatory requirements). Wilson Sandford did so, and continue to do so, on the instructions of Mr Skerritt.

7. By 2004 Mr Skerritt and Mr Routledge were also friends, as well as colleagues and, as a result of discussions between them, in Spring 2005 Mr Routledge agreed to purchase 500 shares in the Company. On 31 March 2005 a special resolution was passed by the Company which re-designated the 10,000 ordinary shares in the Company (all of which were held by Mr Skerritt, and his then wife) as 9,500 ordinary A shares and 500 ordinary B shares ("**the Special Resolution**").

8. The Special Resolution set out the rights attached to the A and B shares and provided:

> "That 9,500 of the existing 10,000 ordinary shares of £1.00 each in the Company be re-designated as ordinary 'A' shares of £1.00 each and that the remaining 500 ordinary shares of £1.00 each in the Company be re-designated as ordinary 'B' shares of £1.00 each which shall respectively be held by the members of the Company as follows:

Richard James Skerritt	5,225 ordinary 'A' shares
	275 ordinary 'B' shares
Catherine Yvette Gabrielle Skerritt	4,275 ordinary 'A' shares
	225 ordinary 'B' shares

and that the following rights shall be attached to the ordinary 'A' shares:

(a) the right of the holder to vote at general meetings of the Company;

(b) the right of the holder to receive dividends declared by the Company before all other ordinary shareholders of the Company and in accordance with the policy in relation to dividends as made and as amended by the Company's Board of Directors from time to time;

(c) the right of the holder to share in the proceeds of the Company upon liquidation *pari passu* with all other ordinary shareholders of the Company

and that the following rights shall be attached to the ordinary 'B' shares:

(a) the right of the holder to vote at general meetings of the Company;

(b) the right of the holder to receive dividends declared by the Company but only to the extent that there are profits available for distribution after the declaration of dividends to which the ordinary 'A' shareholders of the Company are entitled and in accordance with the policy in relation to dividends as made and as amended by the Company's Board of Directors from time to time;

(c) the right of the holder to share in the proceeds of the Company upon liquidation *pari passu* with all other ordinary shareholders of the Company"

9. It is paragraph (b) of the rights attaching to the A and B shares that is at the centre of the issues in this case and, in particular, whether there was any policy in relation to dividends and, if there wasn't, what the consequences of that are.

10. The provisions in the Company's articles of association relating to dividends are set out at regulations 102 to 108 of Table A. This means that in taking decisions regarding specific distributions, the directors can decide to declare an interim dividend, and the shareholders acting by ordinary resolution can declare a final dividend (but paying no more in total than the amount recommended by the directors).

11. Between April 2005 and June 2007, Mr Routledge acquired 500 ordinary B shares in the Company, comprising 5% of the total issued share capital. He purchased 170 shares on 12 April 2005 for £17,000, a further 170 shares on 31 March 2006 for £17,000, and the final 160 shares on 19 June 2007 for £16,000. Clause 2.1 of the sale and purchase agreement, which was entered into on or about 31 March 2006, provided that Mr Routledge purchased the shares: "together with all dividends interest bonuses distributions or other rights now or hereafter attaching thereto". However, it was not until 2010 that Mr Routledge's total shareholding of 500 shares was recorded at Companies House. This was an oversight, that needed to be corrected.

12. On or about 12 April 2005 the parties entered into a shareholders' agreement ("**the Shareholders Agreement**") which provided, amongst other things, that: "dividends

shall be declared in accordance with the policy on dividends as set out by the Board from time to time. The company shall promptly notify all Shareholders after any such policy is made or amended" (clause 5.4); "no variation of this Agreement shall be effective unless it is recorded in writing and signed by or on behalf of each of the Shareholders" (clause 12.1); and "any notice or other document to be given hereunder shall be delivered or sent by first class post to the Shareholder to be served at their address or facsimile number (as the case may be) appearing in this Agreement" (clause 13.1). The Shareholders Agreement was not signed. However, there is no dispute that it is binding on the parties, and Mr Skerritt accepted this in an email dated 26 June 2013.

13. Mr Routledge maintains that, as a result of the Special Resolution, both classes of shares carry the right to receive dividends. He also relies on the provisions of the Shareholders Agreement, referred to in the previous paragraph. However, he has never been paid any dividends on the ordinary B shares, whereas in the period 2007 to 2017 dividends in the aggregate sum of £8,275,182.50 were paid on the ordinary A shares held by Mr and Mrs Skerritt. Further, substantial dividends were paid to Mr Skerritt in 2018.

14. It is in this context that Mr Routledge maintains that his rights as a member of the Company have been breached by reason of the non-payment of dividends on the ordinary B shares. He also claims that Mr and Mrs Skerritt have breached their duties as directors of the Company by conducting its affairs in such a way that they received all the dividends paid by the Company, whereas Mr Routledge has never received any dividend at all, and no proper or genuine consideration has been given as to whether any dividends should be paid in respect of the B shares.

15. On 22 November 2017 Mr Routledge presented an unfair prejudice petition under section 994 of the Companies Act 2006 ("**the 2006 Act**") in respect of the Company. He seeks an order requiring Mr and Mrs Skerritt and/or the Company to purchase his shares at a fair value, taking into account the unfairly prejudicial conduct and without discount for minority, and/or compensation for non-payment of dividends.

16. On 15 February 2018 Deputy Registrar Schaffer ordered that there be a trial on all issues of liability with issues of quantum to be dealt with, if necessary, at a subsequent trial.

17. In December 2018 Mr and Mrs Skerritt indicated that they would be prepared to purchase Mr Routledge's shares at a fair value to be determined, potentially, by an independent valuer. However, this proposal (which was 'subject to contract') did not include any relief for the non-payment of dividends, nor did it contain any offer for the payment of Mr Routledge's costs. He therefore regarded this offer as unacceptable (based on *O'Neill v Phillips* [1999] 1 WLR 1092).

18. I heard the trial in relation to liability between 14 and 17 January 2019.

UNFAIR PREJUDICE – GENERAL PRINCIPLES

19. The relevant law is not in dispute and I have adopted the general propositions set out in Mr Davies QC's skeleton argument (at paragraphs 20 to 25 below).

20. If the Court is satisfied, on an application by a member of a company under section 994 of the 2006 Act, that the affairs of the company have been conducted in a manner unfairly prejudicial to the interests of the member, or members generally, the Court may, under section 996 of the 2006 Act, make such order as it thinks fit for the purposes

of giving relief in respect of the matters complained of. It is established that in order for this jurisdiction to be engaged, the conduct complained of must be shown to have been both unfair and prejudicial to the petitioner: *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14.

21. Regarding the concept of unfairness for the purpose of the jurisdiction under section 994 of the 2006 Act, the touchstone for liability is a breach of the agreement between the members regarding the conduct of the affairs of the company: *O'Neill v Phillips* [1999] 1 WLR 1092.

22. The agreement between the members for this purpose is most obviously to be found in the company's articles of association, but its terms may also be derived from other sources, such as separate shareholders' agreements and company resolutions setting out the rights attached to shares. It is also well established that not every breach of the constitution or shareholders agreement will constitute unfairness. Trivial or technical breaches will not.

23. In the present case, for the purposes of identifying the essential agreement governing the parties' participation in the Company, Mr Routledge relies upon the Special Resolution, the Shareholders Agreement and the Company's Articles of Association; i.e. instruments or agreements with obvious constitutional significance as regards the members' rights and interests with respect to the Company, a breach of which would, in principle, plainly be capable of falling within the jurisdiction under section 994 of the 2006 Act.

24. In addition, acts or omissions of a director in breach of duty may amount to unfairly prejudicial conduct of the affairs of the company, particularly where the misconduct is inconsistent with the underlying agreement between the members in relation to the company, or causes the company loss: *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14.

25. In this regard:

   a. It is well established that directors have a duty genuinely to consider whether to make distributions of the company's profits to members: *Re a Company (No. 00370 of 1987) ex p Glossop* [1988] 1 WLR 1068.

   b. This is an aspect of a director's duty under section 172 CA 2006 to act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to the need to act fairly as between members of the company.

   c. The position is summarised in Hollington on Shareholders' Rights *(8th Ed: 2016)* at [7-166], as follows: "the directors owe a duty to consider the payment of dividends on a regular basis, the shareholders having a prima facie right to participate in the profits made by the company which are available for distribution."

   d. There are a number of cases in which the failure of directors properly to address the question of whether to pay dividends has been found to be unfairly prejudicial: e.g. *Re McCarthy Surfacing Ltd* [2008] EWHC 2279 (Ch); *Re J&S Insurance & Financial Consultants Ltd* [2014] EWHC 2206 (Ch).

26. Prejudice must be suffered by the petitioner in his capacity as a member, not in some other capacity. It will usually be financial in character, although it is accepted it does not have to be. Financial harm may be suffered directly or via the company. Mr Thompson QC dealt with the Respondents' case on prejudice in detail at paragraphs 105 to 117 of his skeleton argument. In particular, he emphasised that the petitioner has to establish that prejudice to him as a shareholder has been suffered as a result of any unfair conduct (see, for example, <u>Hollington on Shareholders' Rights</u> (8th Edition) at para 7-127 and *Rock Nominees v RCO (Holdings) Plc* [2004] BCC 466 at [103], [139]-[141]). The Respondents' accept that Mr Routledge's case that there was no dividend policy and, as a result, he gained a *pari passu* entitlement, gives rise to prejudice (paragraph 109 of Mr Thompson QC's skeleton argument). However, the Respondents maintain that all Mr Routledge's other complaints must fail, as they say there is no pleaded case on prejudice.

27. In terms of directors' duties, I was referred to the duties set out in sections 171(a), 172, 173, 174 and 175 of the 2006 Act. In particular, it is well-established that directors are obliged to give genuine and regular (ie in respect of financial accounting period) consideration to the question of whether the company's profits should be distributed to shareholders. Where there are different classes of shares with different rights as regards dividends, the directors would be obliged to consider the position in respect of each class, having regard to the requirement under section 172 of the 2006 Act to act fairly as between different members.

28. Further, a director of a company must exercise independent judgment: section 173 of the 2006 Act. In this context I was referred to a well-known passage from the judgment of Jonathan Parker J in *Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433, ChD at 489, where he said: "In summary, the following general propositions can, in my judgment, be derived from the authorities to which I was referred in relation to the duties of directors: (i) Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them to properly discharge their duties as directors. (ii) Whilst directors are entitled (subject to the articles of association of the Company) to delegate particular functions to those below them in the management chain, and to trust their competence and integrity to a reasonable extent, the exercise of the power of delegation does not absolve a director from the duty to supervise the discharge of delegated functions. (iii) No rule of universal application can be formulated as to the duty referred to in (ii) above. The extent of the duty, and the question whether it has been discharged, must depend on the facts of each particular case, including the director's role in the management of the company".

29. The Respondents rely, amongst other things, on delay and acquiescence in answer to Mr Routledge's claim. They say that he acquiesced in the conduct complained of, made no complaint about it for more than 8 years and then, even after first making a complaint, delayed for a further 3 years before bringing proceedings. The relevant principles on delay and acquiescence are set out in <u>Hollington</u> at para 7-205 to 7-209. There is no statutory time limit for issuing a petition, nor does the equitable doctrine of laches strictly apply where the relief sought is equitable relief. In *Southern Counties Fresh Foods Ltd* [2008] EWHC 2810 (Ch), Mr Justice Warren, having considered what had been said by Sir Donald Rattee in *Re Grandactual Ltd* [2006] BCC 73 at [19] and [20], said this: "… if a course of conduct starting in the remote past has continued to the present time, I see no reason why the entire history of the conduct should not be

brought into account in assessing whether the conduct as a whole has been unfairly prejudicial. Of course, the fact that it may have continued without protest for a long period may show there has been acquiescence and no unfair prejudice; but if the conduct met with regular objection, or even resignation but with clear non-acceptance, it is not be to be rejected *a proiri* as incapable of being entertained by the court as part of the basis for a petition."

30. In relation to the question of delay, in *Re Edwardian Group Ltd* [2018] EWHC 1715 (Ch) at [571] Fancourt J said: "In my judgment, the right approach is to consider how the delay in question should affect the exercise of the court's discretion under section 996 to make such order as it thinks fit …. However, unjustified delay resulting in prejudice or an irretrievable change of position (the essential ingredients of a defence of laches) are likely to be a significant factor in the exercise of the court's discretion to grant or refuse a particular remedy."

ISSUES AT TRIAL

31. The key issues at trial were as follows:

a. Did Mr Skerritt tell Mr Routledge that he would never be paid a dividend in Respect of the B shares, and did Mr Routledge agree to purchase the B shares in 2005 knowing and understanding that to be the case?

b. What is the effect of the Special Resolution on its true construction regarding the payment of dividends?

c. Did the board of directors at any time from 12 April 2005 (the date Mr Routledge acquired his shares) adopt a dividend policy within the meaning of the Special Resolution to the effect that dividends would not be payable on B shares? If so (i) what was it, and (ii) was such a policy notified to Mr Routledge in accordance with clause 5.4 of the Shareholders Agreement? If not, what is the effect of there being no dividend policy within the meaning of the Special Resolution; do the A and B shares rank *pari passu* for dividends?

d. Was it the common understanding and convention of the shareholders that there would be no dividends paid on the B shares and that that was the dividend policy within the meaning of the Special Resolution? Is Mr Routledge estopped from denying that there was such a dividend policy, or from contending that the A and B shares ranked *pari passu* for dividends?

e. Did Mr and/or Mrs Skerritt breach any of their duties as directors of the Company by failing to cause it to pay dividends on the B shares and/or adopting a dividend policy to the effect that no dividends would be paid on the B shares?

f. Has Mr Routledge accepted and/or acquiesced in the conduct of which he complains, and/or delayed in issuing the petition, such that the conduct can no longer be considered unfair or prejudicial so as to warrant any relief?

THE SPECIAL RESOLUTION AND THE DIVIDEND POLICY

The pleadings

32. Before turning to the witness evidence, I should set out how the parties have put their cases in relation to the meaning and effect of the Special Resolution, together with the dividend policy.

33. The amended petition sets out the material parts of the Shareholders Agreement and the Special Resolution and then, at paragraphs 13 to 15, alleges:

> "[13.] … pursuant to the Special Resolution, the shareholders in the Company (whether holders of 'A' shares or 'B' shares) are only entitled to receive dividends in accordance with the policy in relation to dividends as made and as amended by the Company's board of directors from time to time, no such policy (a "**dividend policy**") has ever been adopted by the board of directors of the Company.
>
> [14.] In the premises, in the absence of any dividend policy, the 'A' shares and the 'B' shares rank *pari passu* in all respects as regards entitlements to dividends.
>
> [15.] In the alternative, if any dividend policy was ever adopted by the Company's board of directors, no such policy was ever notified to the Petitioner, as required under clause 5.4 of the Shareholder's Agreement, with the result that the Petitioner was deprived of the opportunity to challenge such policy if it was unfair to the holders of the 'B' shares (which a policy that provided for no dividends on 'B' shares would have been)."

34. The Re-Amended Points of Defence allege:

> [9A.] On its true construction, the Special Resolution, amongst other things:-
>
> (i) did not give the holder of the B shares a right to receive any part of the profits to distributed by the Company; and/or
>
> (ii) did not require the Company or its directors to decide to pay any part of any profits to be distributed by the Company to the holder of the B shares rather than paying all such profits to the holders of the A shares (whatever the circumstances and whatever the level of the Company's profits lawfully available for distribution); and/or
>
> (iii) allowed the directors a complete discretion in making policy in relation to dividends and did not impose any restriction on their freedom to make such policy; and/or
>
> (iv) in particular did not prevent the directors from having a policy in relation to dividends under which no dividends would be paid on the B shares; and/or

(v) did not in any circumstances provide that the holder of the B shares should be entitled as of right to rank *pari passu* with the holder of the A shares in respect of dividends (whether in the absence of a policy in relation to dividends or in any other circumstances)…

[13.] Further, as to Paragraph 9.6 and clause 5.4 of the Shareholders' Agreement, as the Petitioner knew and agreed in entering into the Shareholders' Agreement, as was the basis of the Investment, and as the Petitioner was at all material times aware, <u>the policy of the Board was at all material times from the re-designation of B shares, to take effect from the Shareholders' Agreement, that there would not be dividends on the Petitioner's B shares ("**the Dividend Policy**")</u>. Further, clause 5.4 of the Shareholders' Agreement was included in order to give effect to and provide for the parties' agreement, and the corresponding Dividend Policy, that there would not be dividends on the B shares. Further, it was the common understanding of the parties and the ongoing basis and convention on which they operated the Shareholders' Agreement for many years that there would be no dividends on the B shares in the Company and that that was the Board's Dividend Policy…

[17.] Paragraphs 13 and 14 are denied. The facts and matters set out above are repeated. Further, in accordance with the Dividend Policy, which the Petitioner was aware of and agreed to when he made the Investment, dividends were not paid on B shares. Further, the Dividend Policy was under the Special Resolution a matter for the discretion of the Respondents, and that discretion was in fact exercised in accordance with the constitution of the Company including the Special Resolution and in accordance with the agreement of the Petitioner and the Investment did not include dividend rights. Further or alternatively, it is denied that under the Special Resolution (or otherwise), in the absence of a dividend policy, the A and B shares would rank *pari passu* in all respects as regards entitlement to dividends. The Special Resolution in particular makes no such provision. On the contrary, its express terms are entirely inconsistent with any such *pari passu* ranking, providing instead expressly that the holder of A shares is entitled to receive dividends "*before all other ordinary shareholders of the Company*" (<u>underlining</u> added)

35. In the Amended Points of Reply, paragraph 13 is denied. The reply to paragraph 9A is as follows:

"[9A.] Save that it is admitted that under the arrangement introduced by the Special Resolution it is possible that the directors of the Company could validly adopt a dividend policy pursuant to which, in respect of a particular financial period, the holders of 'B' shares might not receive any dividends, paragraph 9A is denied. In particular:

[9A.1] It is denied that under the arrangement introduced by the Special Resolution the directors of the Company could validly adopt a dividend policy to the effect that the holders of 'B' shares could never receive dividends.

[9A.2] It is denied that the Special Resolution did not confer rights in respect of dividends upon the ordinary 'B' shares. The rights conferred upon the ordinary

'B' shares under the Special Resolution included the right to receive dividends in accordance with the policy on dividends as made and as amended by the Company's board of directors from time to time.

[9A.3] It is denied that following the passing of the Special Resolution the directors of the Company had a complete discretion in relation to dividends. Pursuant to the Special Resolution, the rights in respect of dividends attached to the ordinary 'A' and ordinary 'B' shares were subject to the policy on dividends as made and as amended by the Company's board of directors from time to time;

[9A.4] Further, the operation of the Special Resolution in relation to the dividend rights attached to the ordinary 'A' shares and the ordinary 'B' shares was premised upon there being in place a policy on dividends duly adopted by the Company's board of directors. If there was no policy on dividends duly adopted by the Company's board of directors, the Special Resolution was not effective either to grant or to restrict rights in respect of dividends.

Accordingly, absent a policy on dividends duly adopted by the Company's board of directors, the ordinary 'A' shares and the ordinary 'B' shares rank *pari passu* in all respects as regards entitlement to dividends."

<u>Respondents' solicitors' letter dated 3 January 2019</u>

36. On 3 January 2019 Mr Skerritt's solicitors said this in relation to their client's case in relation to the dividend policy:

"[a.] It is correct that it is not our clients' case that there was in fact a dividend policy to the effect that the A shares had a preferential right in respect of dividends up to an amount equivalent to what Mr Skerritt might otherwise expect to receive by way of remuneration, salary and commission.

[b.] Our clients' case, as has been set out from the start, is that the dividend policy was that there would not be dividends paid on the B shares (see paragraph 13 of our clients' Points of Defence).

[c.] It is not our clients' case that there was a policy that dividends would never be paid on the B shares. Any policy was obviously subject to consideration and change.

[d.] The dividend policy that there would not be dividends paid on the B shares was in fact considered but remained unchanged: Skerritt 1 at paragraph 32."

<u>The parties' arguments at trial</u>

37. Mr Thompson QC for the Respondents argues that the Special Resolution expressly states that the A shareholders are to be paid in priority to the B shareholders. He says that much could not be clearer. The Special Resolution does not give the A shareholders a *fixed* entitlement, after which the B shareholders become entitled. Instead the decision makers (the directors and the shareholders) are to decide how much the A shareholders are to be paid. The only restriction, he says, is that the A dividends must be in accordance with the directors' dividend policy from time to time.

38. He says that the Special Resolution contains no restrictions on the content of the directors' policy. None are expressed and there is no basis for implying any restrictions. He says there is no requirement that the policy be written down.

39. He then says that, even if an A dividend *could* be paid in accordance with the directors' dividend policy, it would not *have* to be. That would ultimately be for the relevant decision-makers (the shareholders and/or the directors) to decide – as is normal in relation to any dividend that is not fixed (e.g. a fixed % dividend on preference shares). He says the provisions of the Special Resolution merely *empower* the payment of dividends; they do not *prescribe* payment, leaving that ultimately to the discretion of the shareholders and/or the directors.

40. He further says that the Special Resolution makes it clear that at any particular time a preferential A dividend may be paid without any B dividend being paid. That is the clear effect of the provision for priority for A dividends. However, he says it also clear from the fact that it is spelt out in particular that *all* of the available profits *can* be paid to the A shareholders leaving nothing for the B shareholders: (i) paragraph (b) in relation to the B shares says that the B shares may be paid dividends "only to the extent that there are profits available for distribution after the declaration of dividends to which the ordinary A shareholders of the Company are entitled"; and (ii) that makes it clear that there may be *no* profits available after payment of an A dividend. Finally, Mr Thompson QC says even if profits are available for distribution after the payment of an A dividend, the B shareholders can only be paid a dividend if that is in accordance with the directors' dividend policy from time to time. And, again, as with A dividends, even if a B dividend *could* be paid in accordance with the directors' dividend policy, it would not *have* to be. That would again ultimately be for the relevant decision-makers (the shareholders and/or the directors).

41. Mr Davies QC for Mr Routledge argues that under the Special Resolution, the A shares were given a preferential right, "to receive dividends declared by the Company before all other ordinary shareholders of the Company", but the extent to which the A shares might be preferred was not stipulated. Instead, the Special Resolution provided that the declaration of dividends on the A shares was a matter to be governed by, "the policy in relation to dividends as made and amended by the Company's Board of Directors from time to time".

42. He therefore says the A shares' preferential right to dividends was dependent upon there being a dividend policy adopted by the board of directors; it was not simply a matter for the directors' discretion 'at large'. Absent a board policy on dividends, the preferential right could not operate.

43. Regarding the B shares, and effectively as a corollary of the provisions in relation to the A shares, the Special Resolution provided that the B shares carried the right to receive dividends, "to the extent that there are profits available for distribution after the declaration of dividends on" the A shares, and also, "in accordance with the policy in relation to dividends as made and amended by the Company's Board of Directors from time to time". This merely reiterates that the existence of a board policy on dividends is essential to the operation of the dividend regime introduced by the Special Resolution; absent such a policy, there would be no basis for treating the A hares and the B shares differently.

44. Mr Davies QC concludes by arguing that the central importance of the board policy on dividends is reinforced by the Shareholders Agreement, which provides under clause

5.4 that, "Dividends shall be declared in accordance with the policy on dividends as set by the Board from time to time," and, further, that, "The Company shall promptly notify all Shareholders after any such policy is made or amended".

Conclusion

45. The Special Resolution states that the A shareholders have the right to receive dividends declared by the Company in priority to the B Shareholders. However, that does not give the A shareholders an unqualified right to receive dividends ahead of the B shareholders. Rather, the words "and in accordance with the policy" make it clear that such dividends must be declared in accordance with the policy in relation to dividends as made and as amended by the Company's board of directors from time to time.

46. Therefore, there must be a board policy against which those taking the decisions in relation to dividends, whether at a board meeting or general meeting, can consider the factor or factors the policy identifies and then reach a decision on the amount of the dividend to be declared on the A shares. This decision is not a decision which is "at large" or where the Company, whether at a board meeting or general meeting, has a complete discretion to declare dividends in favour of the A shareholders. Rather, decision makers are constrained by the board policy in relation to dividends and, without it, they cannot properly identify the dividend which can be declared in favour of the A shareholders before the B shareholders. The very purpose of the policy is to work this out so as to identify what dividend should be declared on the A shares ahead of the B shares, and thereby identify whether there would be any profits available for distribution to the B shareholders. This corresponds with the rights of the B shareholders set out in paragraph (b) of the Special Resolution which are, as Mr Davies QC says, effectively the corollary of the provisions in relation to the A shares.

47. The existence of the board policy in relation to dividends is therefore critical to identifying the difference between the rights of the A and B shareholders, as it is a key component of the dividend regime contained in the Special Resolution. Without it, it is impossible to distinguish between the rights of the A and B shareholders to dividends. This is because, if there is no dividend policy, then an essential element of the machinery governing the process for declaring dividends is missing and there is then no means of identifying (i) the preferential basis on which the dividend on the A shares can to be declared first, or (ii) whether there are any distributable profits available for B shareholders.

48. I therefore agree with Mr Davies QC that, if no policy on dividends was adopted by the board of directors, there is no basis for treating the A shares and the B shares differently in respect of dividends. Prior to the Special Resolution, the B shares and the A shares were all ordinary shares, and the operation of the dividend regime introduced by the Special Resolution depended entirely upon the existence of a board policy on dividends. Therefore, and as a matter of construction, if there is no board policy in relation to dividends the B shares have throughout ranked *pari passu* with the A shares in respect of dividends. This reflects the default position as a matter of law. Thus, absent any applicable distinguishing provision in the Articles of Association, the shares of a company rank equally: *Birch v Cropper* (1889) 14 App Cas 525, per Lord Macnaghten at 543.

49. The next point is to identify the requirements of the board policy under the Special Resolution. I agree with Mr Thompson QC, that when considered in isolation, the

Special Resolution does not specify that the board policy has to be in writing. However, the Special Resolution cannot be considered in isolation in the present circumstances. Rather, it has to be considered together with the Shareholders Agreement and, in particular, the requirements of clauses 5.4 and 13.1 of the Shareholders Agreement. When that is done, it is quite clear that: (i) the board is required to set a policy on dividends; (ii) the Company shall notify the shareholders of that policy; and (iii) any such notification shall be in writing. Therefore, at the very least, the shareholders are entitled to receive written notification from the Company of the policy which has been set by the board on dividends.

50. There is no dispute that the Company never sent Mr Routledge any written notification of the policy set by the board on dividends. Further, before the issue of these proceedings, there are no Company minutes (or indeed any other document) which at any point identify a policy on dividends set by the board, and there are no Company minutes (or indeed any other documents) which show that any decisions in relation to dividends were taken in relation to any policy set by the board (whether orally or in writing). However, whether there was a board policy in fact, or whether Mr Skerritt told Mr Routledge before he invested in the Company that no dividends would be paid on the B shares, are matters which were very much in dispute at trial, and in respect of which I heard evidence. It is in that context that I now turn to the witness evidence, which I will deal with in some detail.

WITNESS EVIDENCE

51. The factual findings the Court is required to make in this case stretch back to discussions between Mr Skerritt and Mr Routledge over 14 years ago. They were then friends and their relationship continued amicably until it broke down in 2014.

52. In these circumstances:

    a. It is plain that I have to form a view as to the credibility of the witnesses, and Decide which of the evidence I have heard is, after such a long passage of time, actually reliable and most likely to be true (see, for example, *EPI Environmental Technologies Inc v Symphony Plastic Technologies plc (Practice Note)* [2005] 1 WLR 3456, at 3470H-3471C, Peter Smith J).

    b. The most important clues in relation to what did or did not happen are in the contemporaneous emails and other documents. In this case there are still several documents available which pre-date the dispute, and go back to 2004.

    c. It is necessary to consider whether the witnesses can actually remember what happened many years ago and, to the extent they can recall what happened, whether that recollection is, or is likely to be, true.

53. I heard evidence from seven witnesses. Mr Routledge gave evidence in support of the petition, but did not call any other witnesses. For the Respondents, Mr Skerritt gave evidence, and they also called Mr Stephen Gabbitas, Mrs Sally Gabbitas, Mr Keith Bonner, Ms Louise Hearn and Mr Andrew Merricks. The evidence in chief of all of these witnesses was contained in witness statements, which they were then cross-examined on. The Respondents did not call Mrs Skerritt, so there was no evidence from her. I shall need to say something about that later in this judgment.

54. Mr Routledge was subject to very thorough cross examination. He was, in my view, a careful witness and I am quite satisfied he was trying to assist the court and gave truthful answers to the questions he was asked, and I accept his evidence. If there is a dispute between the evidence of Mr Routledge and Mr Skerritt, I prefer the evidence of Mr Routledge.

55. Mr Skerritt plainly runs a very successful business and is talented at what he does. However, in terms of the detailed administration of the Company's affairs, he relies on the Company's accountants, Wilson Sandford, and also his own staff. He is not, for example, someone who pays close attention to the paperwork, in relation to minutes of meetings and so on. Rather, he leaves it to his accountants to ensure any paperwork is in order, and then signs what he is asked to. In significant parts of his evidence, I did not find Mr Skerritt to be a reliable witness. In particular, Mr Skerritt's evidence that, before Mr Routledge entered into the share purchase agreement in April 2005, he had told him that no dividends would be paid on the B shares is not supported by the contemporaneous documents and is not true. In addition to that, a considerable amount of evidence emerged during the course of Mr Skerritt's cross-examination, which was not contained in his witness statements. In particular, Mr Skerritt provided a description of the dividend policy, which was very different to his pleaded case, and a recent letter from his solicitors dated 3 January 2019. In these circumstances, on the central issues in the case, I am unable to accept Mr Skerritt's evidence unless it is corroborated by other witness evidence, or documentary evidence.

56. The other witnesses called by the Respondents gave evidence which was very brief and, in part, peripheral to the main issues. I therefore deal with my assessment of their evidence where it arises in the chronology.

FINDINGS OF FACT

May 2002: Mr Routledge joins the Company

57. Mr Routledge left his job at Lloyds TSB Plc to join the business in 2002. It was in 2002 that he qualified as an IFA. Mr Routledge, together with all the other IFAs, were self-employed. Mr Routledge's contract with the Company was dated 21 May 2002. The contract provided that the Company agreed to pay Mr Routledge "60% of net commissions up to total commissions written of £100,000 and 70% thereafter". However, before Mr Routledge was paid any commissions, the Company received 9.25% on all income generated (which was "badged" as compliance costs), and this was deducted before Mr Routledge became entitled to any commission. Mr Routledge was at the Company for almost 10 years, and left in January 2012 to join Pembroke Financial Services Ltd. Until 2011, his principal role was providing mortgage advice to the Company's clients introduced through estate agents.

2002 - 2004: Mr Skerritt's remuneration

58. Mr Skerritt was the managing director of the Company, and he worked full-time for the Company. He also had his own clients, and generated income for the Company like the IFAs. In 2004/2005 he generated more income than anyone else. However, unlike all the IFAs, the Company did not pay Mr Skerritt commission. Rather, Mr Skerritt was paid a small salary, the equivalent to a tax free personal allowance, and he received

dividends on top of this. Mr Skerritt told Mr Routledge that he paid himself dividends, before Mr Routledge acquired the shares in April 2005. This can be seen from the email exchanges at the time, which are set out below.

59. Mr Skerritt also had a director's loan account, and this has been in place since the Company was established in 2000. Originally it was in credit. The position today is that, on the advice of Wilson Sandford, he pays himself from the director's loan account, and then it is cleared at certain periods or at the end of each year when dividends are declared on the A shares.

March 2004: Invitation to purchase shares in the Company

60. Mr Routledge accepted that his main purpose of investing in shares in the Company was capital appreciation. He was proud to be associated with the Company as it was, in his words, "a good company". I turn next to the events in 2004 which led Mr Routledge to purchasing shares in the Company in Spring 2005.

61. In March 2004 Mr Skerritt invited Mr Routledge, and Mr Michael Davies (another mortgage adviser at the Company) and Mr Steve Gabbitas, to join him in a bar close to the Company's offices in Hove, called Snafu. Mr Skerritt wanted to talk to Mr Routledge, Mr Davies and Mr Gabbitas about his proposal that they might each invest in the Company by purchasing shares from him. I accept Mr Routledge's evidence that this proposal originated from Mr Skerritt, and nowhere else, and that there had been no previous discussions about this and, as far as Mr Routledge was concerned, the suggestion came "somewhat out of the blue".

62. However, Mr Routledge understood that the proposal was in Mr Skerritt's interest, as he wanted to try and tie each of them to the Company. This is because they were all self-employed and significant business writers to the Company's practice. That evening Mr Skerritt asked Mr Routledge, Mr Davies and Mr Gabbitas to come up with a valuation for the Company. However, before they did so, a few days later Mr Skerritt volunteered that the Company was worth £1 million.

63. On 16 March 2004 Mr Skerritt emailed Mr Gabbitas, Mr Davies, Mr Routledge, together with Ms Sally Ellis, and said: "Silly question really, but am I safe to assume that nobody wishes to take up the option of shares at the current time? Can you just confirm for my records." Mr Routledge responded the same day and said: "I am interested (Ursula and I have spoken at great length about it) and feel that I really want to consolidate my position here, it is a great opportunity for us to be part of the Skerritt company however, I feel that the valuation represents a very full price, and at that level, do not wish to take up the option." At that time Mr Routledge had two small children and his partner, Ursula, had only just returned to work after maternity leave. They had some savings, but not the full £50,000 to enable them to go ahead with Mr Skerritt's offer. Therefore, although Mr Routledge had been flattered to have been offered shares by Mr Skerritt, he felt he could not go ahead at that time.

64. Mr Davies, on the other hand, was not interested at all and said this: "Unfortunately the decision is no. Not one particular reason but mostly I don't want to part with my money, I think the price is much too high and having/not having shares doesn't really change anything for me in terms of commitment, retention, input – I just miss out on future potential returns. Thanks for the offer but not for me now." It is not clear what Mr Davies means by "future potential returns". However, one possibility is that this is a reference to dividends payable on the shares in the future.

65. Mr Steve Gabbitas was not interested either and rejected the offer very quickly. In cross-examination, Mr Gabbitas explained that Mr Skerritt presented the offer that dividends "were totally at the discretion of Mr Skerritt". Mr Gabbitas took that to mean that "because he didn't have to pay" he wouldn't pay. I accept that evidence which corroborates Mr Routledge's understanding that dividends would be available on the shares in the Company Mr Skerritt was offering for sale. Mrs Sally Gabbitas, Mr Gabbitas' wife, also gave evidence. She was the office manager at the Company from 1998 until 2006. She said that she was surprised about Mr Routledge's decision to invest in the Company. However, she was not a party to any of the negotiations, and did not know what was said. In cross-examination she also accepted that she did not have full information about the rights which attached to the B shares in the Company.

66. I do not accept the evidence of Mr Bonner that, in early 2004, Mr Routledge told him that he had been offered a 5% shareholding in the Company for £50,000 and the shares would not attract dividends. First, it is inconsistent with the evidence of Mr Gabbitas, and what he was told by Mr Skerritt (and Mr Routledge and Mr Gabbitas were told the same thing by Mr Skerritt). Second, it is also inconsistent with the evidence of Mr Routledge. Third, it is inconsistent with the few contemporaneous documents which are available, and which are set out below. Fourth, Mr Bonner is a friend of Mr Skerritt, and he fell out with Mr Routledge in 2016 when he left Pembroke Financial Services Ltd, Mr Bonner's company. In my view, in wishing to assist the Respondents, Mr Bonner has, with the passage of time, convinced himself of the terms of a conversation, which did not take place on the basis he now believes, and he is in error and mistaken about it.

67. Mr Merricks, who has been at the Company since April 2004 gave evidence that, when he joined, Mr Skerritt offered him "the same deal that he had offered to the other Financial Advisers working at the Company" and "the holders of the B shares would not receive dividends". I do not accept Mr Merricks' evidence that Mr Skerritt said there would not be any dividends on the B shares. Apart from anything else, the idea in relation to the B shares did not arise until July 2004, and Mr Merricks' recollection is inconsistent with the evidence of Mr Gabbitas. In my view, after such a long passage of time, Mr Merricks is now mistaken about what he says Mr Skerritt said about dividends.

68. Between 16 March 2004 and June 2004 Mr Routledge met Mr Skerritt socially a number of times. Mr Routledge's evidence, which I accept, was that in this period Mr Skerritt explained to him how he had valued the Company at £1 million. Mr Skerritt told Mr Routledge that it was based on "circa 3 x turnover (renewal fees)", which he said was a fair value. The business turnover at the time was approximately £300,000 and, to Mr Routledge's knowledge, a multiple of that nature was consistent with how IFA practices were routinely valued. It was on that basis that Mr Routledge decided that the figure provided by Mr Skerritt was broadly in line with the normal market expectations and, to him, appeared to be a fair value, which he was prepared to accept. He did not check this by reference, for example, to the Company's accounts, as he relied on the information provided by Mr Skerritt.

69. It was as a result of further discussions with Mr Skerritt that, by the end of June 2004, Mr Routledge had changed his mind about investing in the Company and he decided to purchase the shares in the Company. He agreed, in principle, to acquire a 5% equity shareholding, amounting to 500 of its 10,000 issued shares, for £50,000, being 5% of

£1 million. He thought the shares he was acquiring were the same as those held by Mr and Mrs Skerritt.

June 2004: Draft EGM Notice and shareholders' agreement

70. Mr Skerritt then instructed Mr Tim Smith of Griffith Smith, solicitors ("**Mr Smith**"), to draft the necessary paperwork. At the end of June 2004 Mr Smith sent Mr Skerritt and Mr Routledge a draft shareholders agreement and a draft notice of an extraordinary general meeting to pass a special resolution.

71. The rights attached to the A and B shares were drafted in these terms:

> "and that the following rights shall be attached to the ordinary 'A' shares: (a) the right of the holder to vote at general meetings of the Company; (b) the right of the holder to receive dividends declared by the Company before all other ordinary shareholders of the Company; and (c) the right of the holder to share in the proceeds of the Company upon liquidation *pari passu* with all other ordinary shareholders of the Company
>
> and that the following rights shall be attached to the ordinary 'B' shares: (a) the right of the holder to vote at general meetings of the Company; (b) the right of the holder to receive dividends declared by the Company but only to the extent that there are profits available for distribution after the declaration of dividends to which the ordinary 'A' shareholders of the Company are entitled; (c) the right of the holder to share in the proceeds of the Company upon liquidation *pari passu* with all other ordinary shareholders of the Company"

72. On receiving the draft shareholders' agreement, Mr Routledge could see it was proposed that the shares should be split into A and B shares, and that he would acquire a different class of shares, to that held by Mr and Mrs Skerritt. Mr Routledge took advice from a solicitor, Mr John Ward of Osman Ward about this, and then emailed Mr Skerritt on 8 July 2004 expressing his concerns. Mr Routledge said this to Mr Skerritt: "Have gone thru agreement with Ursula and took the opportunity of speak with John Ward from Osman Ward… The only concern is the way the shares have been split into 'a' and 'b' and John pointed out, it dilutes the 5% shareholding, and it is not as marketable and valuable as the 'a' holding shares. He has suggested an extra paragraph which would says (sic) that the 'b' shares be converted to 'a' shares at some point in the future, namely after the final instalment has been made. He also feels that also the future buying of shares is agreed naming the price and times to be purchased. … What do you think?". There is no express reference to dividends in this email, and Mr Routledge accepted that in cross-examination. His concern was, because the shares were to be split into two classes, the B shares would be of less value.

73. Mr Skerritt emailed Mr Routledge back 1.5 hours later and said this: "Probably a good idea to chat this through, but the reasoning behind the couple of points raised, is as follows: At the moment, I pay myself mostly dividends, to save National Insurance and this reflects my earnings. If we both had 'a' shares, you would automatically be entitled to your percentage of what I paid out as my income, which would obviously be costly for me. This was Tim Smith's way around this – we can discuss. Reason for not having a formal agreement for prices and times of shares being purchased, is that this would then mean the proceeds for me are all taxable in this tax year. That would basically mean that I would pay about £14,000 in CGT, whereas if the purchase is not

contractual, I can use mine and Katrina's annual £8,200 CGT allowances, which would mean that the tax is negligible. We can chat through."

74. In his witness statement Mr Routledge said this about that email: "What I understood Richard to be saying in his email was that he was looking to ensure that the Company did not have to pay me every time that he was paid remuneration for his services in the form of dividends, it being his practice to receive most of his remuneration by way of dividends. Thus, he was only proposing different rights for me to the extent that it was necessary to preserve the tax beneficial arrangements that he operated in respect of his own remuneration. There was no suggestion that I should be cut out of any entitlement to any dividends whatsoever." I accept that evidence from Mr Routledge.

75. Following Mr Skerritt's email, Mr Routledge had a conversation with him and, having done so, went back to Mr Smith. This was because, first of all, Mr Routledge wanted to understand why it was that Mr Skerritt was proposing two classes of shares. In his oral evidence he explained, and I accept, that his concerns about "the valuation of the shares is one and the same: it is about the dividends and the class of shares". Further, Mr Routledge was adamant, and I accept, that Mr Skerritt never told him that there was going to be a policy that no dividends would be paid on the B shares. Mr Routledge said that he wanted to understand why Mr Skerritt was proposing the two separate classes, and he asked him about it. Mr Skerritt explained to him what he wanted to do, and he understood that. However, Mr Routledge specifically raised his concern that he might not get a dividend, and he asked Mr Skerritt about that as well. Mr Skerritt told him that "he couldn't add anything further to what he had already told me, and suggested that I take the matter up with his solicitor", which he did the same afternoon.

76. Mr Routledge set out his concerns to Mr Smith as follows: "Richard has asked me to contact you direct in respect of agreement. I was wondering whether you could add clarity on a point I raised with him. My concern is the division of 'a' and 'b' shares, therefore diluting my interest of 5% within the company. Our interpretation of the document means that I could never actually receive a dividend, this means the value and holding is not a marketable/attractive as the 'a' holdings shares. John Ward has suggested a paragraph be inserted which says the 'b' shares be converted into 'a' shares at some point in the future, namely after the final instalment has been made. Your comments and clarity are appreciated."

77. Mr Smith responded by email almost immediately to Mr Routledge and said: "I need to consult Richard before replying. I've sent him an email and will get back to you."

78. In any event it is clear at this point that Mr Routledge understood, if he became a shareholder, that would not affect the way Mr Skerritt was remunerated and the split between the A and the B shares was there "to protect [Mr Skerritt's] earnings". He also understood that no dividends would be paid to him, if it conflicted with Mr Skerritt's practice of remunerating himself by way of dividends paid on the A shares. However, that did not mean that Mr Routledge understood, or agreed, that no dividends would ever be paid on the B shares he was being offered in the Company. Rather, Mr Routledge's understanding was that dividends would be paid on the B shares, although he understood this to be at some point in the future.

<u>July 2004: Amended drafts of EGM notice and shareholders' agreement</u>

79. On 9 July 2004 Mr Smith emailed Mr Skerritt amended drafts of the EGM notice and shareholders' agreement. In the covering email Mr Smith explained: "In the EGM

Notice I have added to paragraph (b) in both sets of rights: as you will see this now refers to a policy of the Board on dividends. In the Shareholders Agreement I have added a new Clause 5.4 which is hopefully self-explanatory. The policy on dividends should be drafted – do you want me to produce a first (short) draft." Mr Skerritt did not respond to that email, and Mr Smith did not produce a policy on dividends. In cross-examination Mr Skerritt said that Mr Smith told him that the dividend policy did not have to be in writing. I do not accept that as a credible explanation as to why the policy was not prepared. Rather, what seems more likely is that Mr Skerritt did not follow up on Mr Smith's email and, as a result, a written dividend policy was not drawn up.

80. The amended draft of the EGM notice provided that (and the amendments are shown with underlining) in relation to:

a. paragraph (b) of the rights attached to the 'A' shares it should be amended to read: "(b) the right of the holder to receive dividends declared by the Company before all other ordinary shareholders of the Company <u>and in accordance with the policy in relation to dividends as made and as amended by the Company's Board of Directors from time to time</u>".

b. paragraph (b) of the rights attached to the 'B' shares it should be amended to read "(b) the right of the holder to receive dividends declared by the Company but only to the extent that there are profits available for distribution after the declaration of dividends to which the ordinary 'A' shareholders of the Company are entitled <u>and in accordance with the policy in relation to dividends as made and as amended by the Company's Board of Directors from time to time</u>".

81. The amended clause 5.4 in the Shareholders Agreement provided that: "Dividends shall be declared in accordance with the policy on dividends as set by the Board from time to time. The Company shall promptly notify all Shareholders after any such policy is made or amended". Having made these amendments the EGM notice and shareholders' agreement remained in this form until the Special Resolution was passed, and the Shareholders Agreement entered into, in Spring 2005. Mr Routledge did not take any independent legal advice on these documents.

82. Mr Skerritt was asked about the purpose of the dividend policy in cross-examination:

Q: The purpose of it was to regulate the rights of both classes –

A: Yes.

Q: -- so that one would know when the preferential rights of the A shares end and when the subordinated rights of the B shares begin; would you agree with that formulation?

A: I think so. I don't fully understand the kind of, the terminology there, but my understanding is that it's not just when the preferential rights end, it's also a decision made by the board of directors which would affect that.

Q: Of course, the board of directors, each time, its considering a dividend, has to exercise its discretion: I agree with that.

A: Yes.

83. On 10 August 2004 Mr Routledge emailed Mr Skerritt as follows: "Thanks for the amendment and time taken so far in this … really appreciated. Everything seems fine, from the last email Tim sent, he commented about drawing up the policy on divs … has that been done yet? Kinda hoping to get the whole thing sorted ASAP ideally before Friday if poss, as I will be off, gotta to do a wedding thing … but if not soon after I return." Mr Routledge then went off on leave for three weeks to get married.

84. On 15 October 2004 Mr Routledge, now back from his honeymoon, emailed Mr Skerritt again: "Basically, I am still waiting for you to get back re; policy of divs, but I did meet with accountant today for his comments. Both the solicitor and accountant have commented on the 'b' shares not being as favourable as the 'a' holding ones, I do understand your reasoning behind this with your obvious concern as to costs and your income. The accountant did offer perhaps a compromise on this, whereby a waiver of dividends is signed by me for a set period in exchange for 'a' shares, as you know the dividend income is not the principal reason for wanting to invest, and I am happy to waive that part for the near term to address your concern, but obviously for the long term it would be nice to think that there is the possibility of a dividend in the future. Just wanted to explain this to you as I am conscious that we have not spoken about [this] for a while. Ursula and I are keen to move things forward to a resolution. As and when let me know your thoughts."

85. Mr Routledge was asked about this email in cross-examination. It was put to him that Mr Skerritt had already told him that he was not going to get a dividend on the B shares, and in his email he was trying to secure the possibility of a dividend in the future. Mr Routledge did not agree with that, and I accept his evidence. He said the prospect of the dividend was there, and in this email he was trying to put a solution in place in order to protect Mr Skerritt's income, and "still left the provision to pay and the prospect of future dividends". Mr Routledge also said, as is set out in this email, that he wanted a dividend policy before he invested. However, he did not ask Mr Skerritt for it again after October 2004, and he did not chase Mr Skerritt for the policy. He said he could have chased, but he did not do so as they were friends, he knew what the Company profits were at the time from Mr Skerritt, and there would not have been anything to distribute to him. However, he trusted Mr Skerritt to distribute profits to him when they were available, and the fact there was no dividend policy in writing did not affect his decision to invest in the Company, which took place in April 2005.

86. Further, I accept Mr Routledge's evidence that at no point after October 2004, and before he invested in the Company, did Mr Skerritt tell him that he would not receive any dividends in respect of the B shares, or that the Company's policy was that no dividends would be paid on the B shares. I also accept that, if Mr Routledge had been told that no dividends would ever be paid on the B shares, then he would not have invested in the Company.

<u>April 2005</u>

87. There was some delay in the parties entering into the necessary documents to give effect to Mr Routledge's share purchase. This was because Mr Skerritt did not want to sell the shares in the Company until after the start of the 2005/2006 tax year.

88. On 12 April 2005 Mr Routledge entered into a written agreement with Mr and Mrs Skerritt whereby they agreed to sell, and he agreed to buy, 170 Ordinary £1 B shares in the Company. Clause 2.1 of the agreement provided that: "The Sellers shall with full

title guarantee sell and the Purchaser shall purchase free from all liens charges rights of pre-emption encumbrances and equities together with all dividends interest bonuses distributions or other rights now or hereafter attaching thereto [170 ordinary 'B' shares of £1 each in the capital of the Company]". Clause 7.2 of the agreement provided that "No variation of this Agreement shall be effective unless it is recorded in writing and signed by or on behalf of each of the Parties." The parties also entered in to the Shareholders Agreement on or about 12 April 2005 (see paragraph 12 above).

89. There was no dividend policy communicated by Mr Skerritt to Mr Routledge after 12 April 2005.

Post-April 2005: Board meetings and general meetings

90. The Company has disclosed minutes of board meetings and general meetings. The first examples of these after April 2005 are recorded as having taken place on 25 May 2005 at 12 Church Road, Hove (which was the Company's office at the time) with Mr and Mrs Skerritt being present. The minutes are signed by Mr Skerritt as a true record of what took place, but are not dated.

91. The minutes of the board meeting record that: "the only item on the agenda was to discuss the declaration of an interim dividend in respect of the year ended 31 December 2005, payable on 25 May 2005. It was agreed that a dividend of £40,000 be declared on the whole of the Issued Share Capital of the Company. The Secretary has arranged for the Companies accounts to be annotated including the funds being made unreservedly available for the use of the Shareholders." The minutes of the general meeting record the following: "Notice of the meeting was waived, as all members entitled to vote at General meetings were present. Dividend – The shareholders having considered the company's position based on the Audited accounts to 31 December 2004 and management information to date, approved the dividend voted by the Directors on 25 May 2005 of £40,000." However, Mr Routledge was not present at this meeting, and was not given any notice of it. The minutes are therefore inaccurate and Mr Routledge's right to attend the general meeting was overlooked.

July 2006

92. On 20 July 2006 Mr Mark Jester, a tax consultant at Wilson Sandford, emailed Mr Skerritt and asked him about the dividends paid on the shares. He said this: "It has recently been brought to my attention that you and Katrina gifted shares to Mike Routledge in April 2005 and 2006. Am I to assume that the dividends paid by the company are only in respect of the 'A' shares, ie to you and Katrina, or are they also to be paid in respect of the 'B' shares, with Mike receiving a share? I await your clarification, so that the next dividend vouchers can be prepared correctly. If Mike is to receive a share of dividends, did he receive any during 2005/6?". Mr Skerritt responded on 27 July 2006 and simply said: "Divis only paid for A shares, so none for Mike". Mr Skerritt sent this email without consulting Mr Routledge or Mrs Skerritt. Further, Mr Routledge's shares were paid for by him, and not a gift. That point was not corrected by Mr Skerritt. In any event, this email from Mr Skerritt to Mr Jester, was just a unilateral statement of what Mr Skerritt was doing in relation to declaring dividends. It was not, for the reasons set out below, a record of a policy in relation to dividends approved by the board, as there was no such policy.

2011: The Company's accounts for the year ended 30 June 2011

93. The Company's accounts for the year ended 30 June 2011 were filed at Companies House on 21 January 2012. The directors' report was approved by the board on 30 November 2011 and the accounts show that, in that year, the dividends paid were £535,000. The profit for the financial year was £547,428 and the turnover was £3,122,107.

2012: Mr Routledge's departure from the Company

94. Mr Routledge left the Company in January 2012, at which point he was still friends with Mr Skerritt.

95. Mr Routledge knew that, from the date he purchased his B shares in April 2005, until the date he left the Company, no dividends had been paid on the B shares. Mr Routledge had no objection to this, and at no point complained to Mr Skerritt. Mr Routledge said in cross-examination that he did look at the Company's accounts in, he thought (but he could not be sure), about 2009 or 2010. He obtained the accounts from Companies House, and he did so in order to check his shares had been registered, and also to look at the dividends that were being paid to Mr Skerritt. Having looked at the accounts, he did not think that the dividends which had been paid to Mr Skerritt were excessive, and he did not discuss with Mr Skerritt the dividends which were being paid on the A shares, or the level of Mr Skerritt's remuneration.

96. In cross-examination Mr Routledge accepted that in all the years he was with the Company, he was not overly concerned to check the dividends being paid on the A shares. There was, for example, financial information on the shared drive (which Mrs Louise Hearn gave evidence about), but he had not troubled to look at any of that. Mr Routledge was asked about this in cross-examination. Mr Thompson QC put to him that in the period from the end of March 2005 until January 2012 he was not "expecting to receive any B dividends because [he] knew there weren't going to be any B dividends, at least until Mr Skerritt had been fully remunerated?". Mr Routledge's answer to that was "Yeah. That's fair." In any event, the first time Mr Routledge complained about not being paid any dividends was, as is set out below, in a letter dated 21 February 2014.

97. However, Mr Routledge also emphasised that, as he was friends with Mr Skerritt, he spent a lot of time with him, and they even shared a personal trainer. He said "a lot of the information I obtained from the Company was from [Mr Skerritt] himself, through socially and otherwise, holidaying together… whilst there is an illusion or there is – it may appear that profits were available for distribution, from conversations I had with [Mr Skerritt] I would know those were earmarked for expansion, they were earmarked for making stage payments on acquisitions that the company had already made, and the plans that the company had in more general, in expanding. So they were not available for distribution, so I didn't complain about that. I was content that the company profits were being deployed in a way to grow the business, and as a shareholder ultimately I thought I would share".

98. On 20 January 2012 Mr Robin Wilson of Wilson Sandford ("**Mr Wilson**") sent an email to Mr Skerritt providing advice in relation to Mr Routledge's departure from the Company, and the valuation of the shares. Mr Wilson's email begins by stating that: "There is no Shareholders Agreement, but there is an unsigned sale and purchase

agreement of a tranche of shares by Michael. However, this does not refer to the formula for the valuation of shares in the event of a subsequent sale by Michael". That was incorrect, as there was a Shareholders Agreement, which also contained provision in relation to the valuation of shares.

99. Nevertheless, Mr Skerritt did not correct Mr Wilson, or provide him with a copy of the Shareholders Agreement. Rather, on 27 February 2012 he adopted Mr Wilson's error, and emailed Mr Routledge in these terms: "… With regards to the share valuation, it did take me by surprise as well. I have spoken with Robin [of Wilson Sandford] and the main factors he has taken into account are: - Share agreement wasn't signed, even though it was prepared; - 5% share is a minority share in the business, so has less value than shares that hold a majority for voting rights (know this is the case as been through with the divorce settlement, where I am buying Kat's shares and a discount was applied to them as they are a minority holding); – the shares don't hold an automatic entitlement to dividends, which we built in to protect me taking my earning as dividends. In terms of my view on valuation, from your email, it sounds as though you have in mind a figure of more than £94K? If that is the case, then that is higher than what I had in mind. If this is the case, then I would agree that we leave things for now …".

100. When Mr Routledge received this email he thought there was a mistake, and that Mr Wilson had overlooked the fact the Shareholders Agreement had been signed. He responded later the same day and said: "I do recall signing an agreement, although I don't have a copy of it, also recall chatting through parts of with Tim Smith perhaps he has it? With regards to value, having just spoken to Urs, she said to just mention the figure to you, that way you know exactly where we are and that is £120k … I must admit this figure in my thoughts had been considerably higher than that, I do recall you offering me £200k a couple of years ago, and more recently saying that UBS had valued the company at £7million. Anyway, they are just all figures, numbers and even more figures etc … but Urs felt that if you knew exactly what we were thinking of instead of unnamed hundreds of thousands then at least you know where we are at, so job done on my part. Let me know what you think … but am happy if you don't feel it's fair, then we just park it to one side and not let it become an issue between us."

101. By an email dated 15 March 2012 Mr Skerritt wrote to Mr Routledge accusing him of "contacting Skerritts' clients and trying to move them over to Pembroke". Mr Routledge responded the same day saying that he had done no such thing.

102. The next email from Mr Skerritt to Mr Routledge was on 17 April 2012. He said this: "Have heard back from Tim [Smith]. Nothing he could add on what Robin [Wilson] said, other than a load of legal stuff that doesn't really affect anything. Let's meet up and discuss, but thought it would be useful if I told you in advance where I am coming from and you many not want to meet up … Robin [Wilson] has given a value of £19k ish, to reflect that fact that the Shareholders' Agreement was not signed, the fact that they are 'B' shares that don't hold an automatic right to dividends and the fact that it is a minority shareholding, which is always discounted when there is a controlling shareholder. As mentioned before, want to try and be fair to both parties and at the end of the day, you don't have to sell, but (you may want to get your own advice on this) Robin [Wilson] was of the opinion that there is no value to you to holding on to the shares that you have. Have asked a couple of people their advice, to try and be fair and the consensus to be reasonable in the circumstances would be to offer what you paid in the first place plus an amount to cover "interest" you could have earnt on the money. Let me know what you think of this approach and if you want to meet up to discuss."

103. Following that Mr Routledge recalled that there were conversations and face-to-face meetings in 2012 when they tried to resolve matters. He remembered the last one was in August 2012, which he remembered very clearly as it was during the Olympics. He recalled saying to Mr Skerritt "it's just about fairness, I just want to be treated fairly". There was no complaint about dividends at that point. Rather, Mr Routledge's much greater concern was the suggestion that his investment of £50,000 was worth £19,000 because it was being said by Mr Skerritt that the Shareholders Agreement had not been signed. He thought Mr Skerritt would correct Mr Wilson's misunderstanding, but he had not done so. This was causing frustration and it was not until June 2013 that Mr Skerritt eventually accepted, as had always been the position, that there was in fact a valid and binding Shareholders Agreement.

The Company's accounts for the years ended 30 June 2012 and 30 June 2013

104. The Company's accounts for the year ended 30 June 2012 were filed at Companies House on 9 March 2013. The directors' report was approved by the board on 28 February 2013 and the accounts show that, in that year, the dividends paid were £961,267. The profit for the financial year was £1,113,384 and the turnover was £4,067,614. The accounts for the year ended 30 June 2013 show that dividends of £673,437 were paid, the profit was £725,635 and the turnover was £4,080,614.

February 2014: Mr Skerritt's proposed hive-out

105. On 7 February 2014 Mr Skerritt emailed Mr Routledge and informed him that "for strategic business reasons which I don't need to go into, I have for some time been planning to hive out [the Company's] wealth management business into a new company ("Newco"). For this purpose, [the Company] would sell the wealth management business to Newco for full value. It is not my objective to reduce the value of your shares in [the Company], but this change could have that effect as the sale proceeds received by [the Company] could be paid out to me as dividends – as you know, I am entitled to receive dividends on my shares separately". Mr Skerritt then offered to purchase Mr Routledge's shares for £70,000, and said the offer was open for acceptance until 28 February 2014. This email was followed by a letter in the same terms, which worried Mr Routledge enormously.

106. It was about this time that Mr Routledge became concerned about the level of remuneration that Mr Skerritt was awarding himself. As a result he instructed Mr Maurice Faull, a forensic accountant at Hilton Sharpe and Clarke, accountants, to look into it. This was because Mr Routledge had noticed (from the latest filed accounts in March 2013) that Mr Skerritt had awarded himself £942,517 in dividends up from £535,000 declared in the previous year. Mr Routledge's evidence, which I accept, was that it was only at this point that he became aware of "the sheer scale of the dividends that had been declared". It was then that he took the view that, even allowing for a reasonable salary for Mr Skerritt, there were sufficient profits to pay him a dividend as a B shareholder in the Company.

107. In the letter dated 21 February 2014 Mr Routledge rejected Mr Skerritt's "hive out" proposal and, as Mr Thompson QC put it, this proposal "went nowhere", and does not amount to conduct falling within section 994. However, what is of more relevance is that in the same letter Mr Routledge expressed his concerns about the way that Mr Skerritt had been declaring dividends in the Company and stated, amongst other things, that "While you may be entitled to dividends in priority, particularly if you are not being

paid a commercial salary by the Company, I simply don't see why I should not be entitled to <u>any</u> share of those profits. I have never received any board policy in relation to dividends, which I should have received under clause 5.4 of our Shareholders Agreement. It seems that you consider that all of the company's profits are yours to do with as you please. I don't accept that you are entitled to use the company in this way, and I believe I should have been granted substantial dividends on my B shares over the past several years." This was the first time that Mr Routledge complained about not being paid any dividends in respect of his B shares.

108. Mr Thompson QC put to Mr Routledge in the course of cross-examination that, in the period March 2005 until February 2014, he was not actually expecting to receive any B dividends. Mr Routledge's answer to that was "I think over the period I was always expecting to receive a dividend when the profits of the company permit… the expectation was there from the very start, the profits of the company as and when the company was profitable". However, Mr Routledge accepted that in the period March 2005 until February 2014 he did not ask Mr Skerritt, or indeed anyone else, what the Company's dividend policy was, and he did not ask for any notification of the policy. Nevertheless, Mr Routledge said he was aware of his rights under the Shareholders Agreement and he assumed there was a dividend policy. He was also well aware that Mr Skerritt was declaring dividends in order to remunerate himself: see, for example, paras 95 and 96 above.

109. Given Mr Routledge understood his rights under the Shareholders Agreement, he could have asked for copy of the dividend policy at any time after 12 April 2005. However, he did not do so. Rather, he assumed that a policy was in place, the effect of which was to declare dividends on the A shares to remunerate Mr Skerritt, and not to declare any dividends on the B shares. Further, Mr Routledge had access to the Company's accounts, and other financial information, and was therefore aware of the sums involved. However, he did not have any issue with this until February 2014, when he complained for the first time in his letter dated 21 February 2014. In these circumstances, I agree with Mr Thompson QC that Mr Routledge accepted, or acquiesced in, the payment of dividends on the A shares in priority, with no payment on the B shares from March 2005 until 21 February 2014. This is because he had all the information available to him to make a complaint against the Respondents, but he did not do so.

110. I now turn to the evidence in relation to the declaration of dividends by the Company.

<u>Declaration of dividends</u>

<u>*(i) Mr Skerritt's remuneration*</u>

111. Mr Davies QC put this to Mr Skerritt in cross-examination: "…but assuming the Company can afford it, … at least as regards your case, that the amount of your dividend should equate to more or less what would be a reasonable amount for your services?". Mr Skerritt's answer to this was: "I think in terms of reasonable rate for my services, yes, I think that's fair".

112. At no point did Mr Skerritt ever seek to agree with the other directors the salary he might be entitled to, and his salary was never decided upon by the directors. He said that in about 2013 or 2014 he asked his PA, Jenny Green, to do some research and find comparative figures in respect of salaries paid to others who carried out the various roles undertaken by Mr Skerritt, as the managing director, together with his roles in

relation to money laundering and compliance. It was, he said, based on that research that a figure of £250,000 per annum was identified for his salary. However, that figure was never considered at a board meeting, or in any way formalised, or applied in relation to identifying the dividends payable on the A shares.

113. In relation to commission, Mr Skerritt has personal clients. These are existing clients and new clients, although the new clients were only referrals from his "existing client bank", and Mr Skerritt now has very few new clients. In relation to fees, new clients pay an initial fee and, if they stay, then they are charged an annual fee for the management of their investments. Mr Skerritt was always aware, in broad terms, of the levels of sales that he was achieving for his own clients, together with what the IFAs were each achieving. Mr Skerritt deals almost entirely with pensions and investment business, which nearly all falls into the "wealth management" side of the Company's business. Of this, 60% is pensions and 40% is investment. He also said he did "the occasional bit of protection business", but that was once or twice a year and was not significant. The clients are charged an annual fee, which Mr Skerritt accepted was a "rolling fee" and the commission rate charged was 1%, and that applies to Mr Skerritt's figures. There was no negotiation between the Company and Mr Skerritt in relation to what commission he should receive on his sales.

114. The only evidence in the trial bundles in relation to Mr Skerritt's commission was contained in an email exchange in September 2004, when Mr Skerritt wanted to book in a meeting with the other IFAs (Mr Gabbitas, Mr Davies, Mr Routledge and Mr Merricks) regarding "the financial plans of the business". In advance of the meeting, Mr Gabbitas emailed Mr Skerritt on 10 September 2004 stating "you quote in your email an industry standard adviser split of 57%. We would like to examine prior to the meeting on what basis/evidence has this figure been formulated." Mr Skerritt responded half an hour later, and said "Yes, I am paying myself the equivalent of £85k per year (not 60% of £300 - £180k) and there is still not a surplus after the end of each month. When you consider the time I spend on the business, staff issues, compliance issues, PI issues, complaints etc. etc. etc, I certainly don't think I should get a lower percentage than the norm". The purpose of that email was for Mr Skerritt to set out, amongst other things, why he should get a commission of 60%, and why that was the appropriate rate for him.

115. Further, if there had been a free-standing negotiation between the Company, independently advised, and Mr Skerritt in relation to the rate of the commission to be paid on his sales, it seems to me that the Company would have pushed Mr Skerritt to a lower rate of commission than a free-standing IFA. This was because, apart from anything else, if Mr Skerritt charged a full commission of, say 70% or 85%, on a contractual basis, the Company could not have afforded to pay him which was a point that Mr Skerritt accepted in cross-examination. Rather, if there had been an independent negotiation between the Company and Mr Skerritt, the most he could have expected to have received as commission on his sales was 60%. This is because the Company could not have afforded to pay him any more than that, and that is the figure set out in his email of 10 September 2004. Further, in terms of identifying the commission Mr Skerritt would then have been entitled to, in addition to his salary, this would have been a simple calculation, a point which Mr Skerritt accepted in cross-examination. All that would have been required would have been to identify his sales in any particular year, and then apply a percentage of 60%. However, this was not a process that Mr Skerritt, or indeed the Company, followed at any time at all.

(ii) Determination of the Dividend

116. In the course of Mr Skerritt's evidence, I asked who took the decisions in relation to the amount of the dividends. In response he said this: "With the actual numbers and the calculations of those figures, it's the accountants that prepare those figures for us: its what we pay them to do. So the accountants will be involved in terms of knowing what dividends have to be declared, which dividends have to be paid to cover that. They also make sure, obviously, dividends are affordable. And from that, the accountants – they act for me personally and for the company, so they will know about my personal tax situation as well".

117. Mr Skerritt was thoroughly cross-examined by Mr Davies QC in relation to the declaration of dividends. I observed and listened to Mr Skerritt very carefully when he was answering these questions. It was clear to me that there was no policy, let alone a written policy, applied in determining how, or on what basis, the dividend would be declared on the shares. Rather, in short, the process applied by Mr Skerritt, in conjunction with Wilson Sandford, involved identifying how much money the Company needed to comply with its regulatory requirements, followed by identifying all its outgoings. Once that had been done, Mr Skerritt could then declare the dividend on the A shares in respect of what was left and, in recent years, the purpose of the year-end dividend has been to clear the very substantial expenditure incurred on Mr Skerritt's interest-free director's loan account. The amount of the dividend has, in effect, matched the amount outstanding on Mr Skerritt's director's loan account, which Mr Skerritt uses to pay all manner of personal expenses.

118. Mr Skerritt was asked to explain the basis on which the dividends were declared on the A shares over the years. In response he identified the following factors:

a. He needed to know what was left as distributable funds, once the Company's capital adequacy requirements had been fulfilled and on-going expenses provided for. Wilson Sandford advised Mr Skerritt as to the Company's capital adequacy requirements (which Mr Skerritt thought was 25% of the Company's fixed costs), together with the Company's expenses in the next 3, 6 and 12 months. These expenses included items such as corporation tax, professional indemnity insurance, IT expenditure and the sums to be paid to the IFAs.

b. He considered whether the Company needed to build up reserves to make acquisitions.

c. The entire history of his services to the Company was relevant he said, as he had been underpaid "in the early years", and he thought it was only fair this should be made up in later years. However, it is not possible to tell what sums Mr Skerritt perceived to be the "backlog" as this was not written down anywhere.

d. Part of the consideration was how much money Mr Skerritt actually needed, and what he would like to take as a dividend. This was certainly a highly relevant consideration, particularly in the context of the director's loan account. However, Mr Skerritt did not expressly mention the director's loan account as one of the factors he took into account.

119. There are a number of important points that arise out of these answers.

120. First, it is clear that the process described by Mr Skerritt, is a process which involves identifying the Company's distributable profits, followed by thinking only about

himself. It is those distributable profits to which the decision makers (whether the directors or shareholders) should apply the dividend policy when considering, and then making, a decision whether to declare a dividend on the A shares. The considerations at (c) and (d) above are either what Mr Skerritt unilaterally thought he was entitled to, or what he "needed" to discharge his liabilities, and significant personal expenditure, in relation to the director's loan account. These considerations do not amount to a "policy in relation to dividends as made by the Company's Board of Directors". Rather, they simply reflect what happened in practice, which was that Mr Skerritt paid himself whatever sum he wanted out of the distributable profits.

121. Second, the process described by Mr Skerritt does not involve any identification of an amount which would be reasonable to pay him as remuneration in any particular period, or year. Further, when Mr Davies QC put to Mr Skerritt that there was no policy in relation to the payment of the dividends on the A shares, Mr Skerritt disagreed and, for the first time in cross-examination, said there had always been a policy, which he described as follows: "The policy on the A shares was to distribute income by way of dividend from the company when available, as you can see from there. And also, part of that, to reflect my remuneration, because that's the way I've always taken my income in terms of dividends". This description of the dividend policy did not form any part of Mr Skerritt's pleaded case.

122. Third, in relation to the factors Mr Skerritt identified he did not mention, or take into any account, the need to consider the position of the holders of the B shares. They were simply not considered at all. However, in response to further questions from Mr Davies QC, Mr Skerritt then tried to say that the B shareholders were considered because it was something that Wilson Sandford raised "as part of their process" and that he regularly considered what would be fair and reasonable for the B shares. This evidence is not supported by the documents in the trial bundles and is not true. Likewise, I do not accept Mr Skerritt's evidence, that he discussed the interests of the B shareholders with Mrs Skerritt or with the other directors, Mr Cardy or Ms McGrath. Apart from anything else, neither Mr Cardy nor Ms McGrath were present at any board meetings when dividends were declared. This simply did not happen, and no consideration was ever given to paying a dividend to the B shareholders.

123. Fourth, as for the director's loan account, Mr Skerritt explained it in these terms in his witness statement: "I use the [director's] loan account to ensure that I have a steady flow of income throughout the year, in anticipation of dividends being paid, but at less frequent intervals throughout the year (usually quarterly). In practice this means that I draw down funds from the director's loan account on a monthly basis. At the end of the year the Company then also pays an interim dividend on the A shares which clears the balance of the director's loan account. This avoids the administrative burden on the Company of paying dividends on a monthly basis".

124. The details of the director's loan account available at trial ran from the end of 2016. The entries show that Mr Skerritt used this loan account like a bank and paid personal expenses through this account, which included his children's school fees, transfers of money to his children, his wife's car, home improvements, the physiotherapist, the water bill, dog food and so on. Indeed, on 9 March 2018 Mr Skerritt paid himself £500,000 when he moved house. That was, as with the other expenses put through his director's loan account, interest-free and was repaid at the end of the year through the declaration of a dividend on the A shares. Most recently the dividend declared on the A shares on 13 December 2018 was £1,750,000, and that was used to clear the balance

on Mr Skerritt's directors' loan account. The reality therefore is that Mr Skerritt has used the director's loan account to pay for his expenses, and those of his family, as and when needed. His general practice was to clear the director's loan account, or substantially pay it down, with quarterly dividends, and then with a very substantial dividend at the end of the year.

(iii) Mrs Skerritt

125. Mrs Skerritt was a director of the Company from the outset. However, she has never had any day to day involvement in the Company's affairs. She has a law degree, and Mr Skerritt's evidence was that she ceased employment when they started a family in 1995. Mrs Skerritt did not give evidence at trial. There is therefore no evidence from Mrs Skerritt about her role as a director and, in particular, her involvement in the Company's decisions to declare dividends in respect of the A shares. Mr Davies QC asked Mr Skerritt as to why Mrs Skerritt was not giving evidence at trial (even though she was a party to the proceedings). Mr Skerritt said this: "I don't think it is something she would choose to do. And in terms of decisions we have made as a company, she relies heavily on me for my judgment and my advice and she tends to follow that. So in that respect, she – I guess she just didn't see the need".

126. In 2011 Mrs Skerritt agreed not to take any share of the substantial year-end dividends paid on the A shares. This was because, as part of the divorce settlement (described as a "collobarative agreement" by Mr Skerritt), Mr Skerritt agreed to pay all their children's expenses and, in particular, the school fees. The total value of the dividends declared in favour of Mrs Skerritt on her A shares, but not paid to her amounts to £5,015,544.70 in the period June 2014 to December 2018.

127. As to her attendance at meetings, Mr Skerritt explained that there was an annual meeting with the accountants. The minutes of these meetings were not disclosed, but Mr Skerritt said that Mrs Skerritt attended the whole of these meetings until about 2014. Mr Skerritt described the meetings as "the most tedious meetings we have ever had" and Mr Wilson insisted that Mrs Skerritt should attend. However, Mr Skerritt said she would find "an excuse to avoid the boring part of [the meeting]", which involved going through the "nitty gritty" of every expense, and she would "escape". Now Mrs Skerritt only attends the "interesting part" of these meetings, which is where the Company's performance is discussed, including dividends. Mr Skerritt said that Mrs Skerritt was sent accounts by Wilson Sandford in advance of Company meetings, but he did not know whether she considered or read them before any meetings.

128. It was clear from Mr Skerritt's answers in cross-examination, that Wilson Sandford have a very firm grip on "the paperwork" in relation to the Company, and for keeping it in order. They are also insistent that, if Mrs Skerritt has to be present at a meeting, that she attends. Nevertheless, it was also clear from Mr Skerritt's evidence, that Mrs Skerritt does not enjoy Company meetings, as she would rather be somewhere else. The minutes of the Company's board meetings, and general meetings, at which dividends were declared are formulaic documents prepared by the accountants.

129. There is no evidence before me to show that, as a director of the Company, Mrs Skerritt actually considered matters independently at meetings, or exercised her independent judgment in doing so. I do not think that she did. I do not accept Mr Skerritt's evidence that Mrs Skerritt was actively involved in a conversation with either with him, or the accountants, in order to work out how much money there was to distribute for the

purpose of declaring dividends. I also do not accept Mr Skerritt's evidence that, based on the information provided by the accountants, he then discussed matters with Mrs Skerritt over a cup of coffee and then made a decision. Rather, given Mrs Skerritt's complete lack of involvement and interest in the Company's affairs, what seems much more likely to me, and what I find, is that Mrs Skerritt did what Mr Skerritt or Wilson Sandford asked her to. I therefore conclude on the evidence before me that Mrs Skerritt did not exercise any independent judgment at all in relation to the decisions to declare dividends on the A shares, and gave no consideration at all to the B shares.

(iv) Dividends declared on the A shares and paid to Mr Skerritt: 2014 to 2018

130. The minutes of the Company's board and general meetings purporting to record decisions in relation to dividends since 2014 have been disclosed. These documents were prepared by Wilson Sandford, and are mostly signed by Mr Skerritt. However, some documents are still not dated, and some were signed many months after the meeting in question. There are inaccuracies in the documents, as set out below. These documents set out the dividends declared. They do not shed any light on the decision making process (which I have described above) and, until 13 December 2018, do not make any mention of a dividend policy. However, what they do show is the very substantial sums of money Mr Skerritt paid himself in dividends in this period and for that reason, I will set out what the documents show in that regard from 2014 onwards.

131. The only people present at these meetings were Mr and Mrs Skerritt. The board meetings were not attended by the other directors, namely Mr Cardy or Ms McGrath. As for the general meetings, Mr Routledge was never given notice, and did not attend any of them. Even so, some of the minutes state: "Notice of the meeting was waived as all members entitled to vote at the General meeting were present" (see, for example, the general meeting on 6 February 2018). This is simply wrong.

132. The Company's minutes and accounts record the following:

a. On 26 June 2014 there was a board meeting and then a general meeting of the Company at the Company's offices in Hove. The directors agreed on an interim dividend of £1,770,335 on the whole of the issued A share capital. Mr and Mrs Skerritt then approved this decision as shareholders (although the minutes of that meeting were not approved by Mr Skerritt until 26 October 2014). On the same day Mr Skerritt was paid £925,000. On 30 June 2014 Mrs Skerritt signed a waiver in respect of the dividend declared on her A shares, which amounted to £845,335. The Company's accounts for the year ended 30 June 2014 record that dividends of £1,050,000 were paid, the profit was £949,175 and the turnover was £4,535,553.

b. On 24 June 2015 there was a board meeting and then a general meeting of the Company. The directors agreed on an interim dividend of £1,763,636 on the whole of the issued A share capital. On the same day Mr Skerritt was paid £970,000. Mrs Skerritt signed a waiver in respect of the dividend declared on her A shares, which amounted to £793,636. The Company's accounts for the year ended 30 June 2015 record that dividends of £1,095,000 were paid, the profit was £1,015,906 and the turnover was £4,890,875.

c. On 6 November 2015 there was a board meeting and then a general meeting of the Company. A dividend of £171,000 was declared on the whole of the issued A

share capital, and on the same day Mr Skerritt was paid £85,500. Mrs Skerritt waived her dividend of £85,500 on 26 November 2015.

d. The same thing happened on 5 April 2016 when there was a board meeting and then a general meeting of the Company. It was agreed that a further interim dividend of £1,818,181.70 be declared on the whole of the issued A share capital, and on the same day Mr Skerritt, was paid £1 million and Mrs Skerritt waived her dividend of £818,181.70. On 31 December 2016 Mr Skerritt was paid a further interim dividend on his A shares of £485,000. It is to be assumed there was a board meeting, and a general meeting, of the Company on the same day at which this dividend was declared, but these minutes were not available.

e. On 6 February 2018 Mr Skerritt signed, as a true record of a general meeting, the minutes of a general meeting on 6 April 2017. Then, under the heading, "Dividend" the minutes record: "The shareholders having considered the company's position based on the accounts to 31 December 2016 and the management information to date, approved the dividend voted by the Directors on 6 April 2017 of £4.30 on the issued 'A' Ordinary Share Capital." This amounted to a dividend of £40,850. The problem with this is that the Company's accounts to 31 December 2006 were not approved by the board until 3 May 2017. They were not available on 6 April 2017, which is the date this meeting was said to have taken place. However, Mr Skerritt was paid £22,478 on 6 April 2017. It therefore looks as though the documents were put together after that date, in order to correspond with the date the dividend was paid to Mr Skerritt in respect of his shares. Mrs Skerritt also signed a waiver in respect of her dividend of £18,372. Further, it was obvious during the course of Mr Skerritt's cross-examination that he was not particularly careful in checking documents before he signed them. He said he tended to look at "the numbers and dates" and that he gets "so many bits of paperwork every day that – just in the normal course of work I tend to look at, … what I consider is relevant …".

f. On 6 February 2018 a dividend was declared, and approved, on the issued A Ordinary Share Capital of £239.23 per share, which totalled £2,272,685. Mr Skerritt was paid £1,250,000 on 31 December 2017, and on 6 February 2018 Mrs Skerritt waived her entitlement to a dividend of £1,022,685.

g. The accounts for the year ended 31 December 2017 were approved by the board on 27 April 2018. These show a profit of £1,797,732, turnover of £7,193,646 and that dividends of £1,328,371 were paid.

133. Then, on 13 December 2018, there is another meeting at which an interim dividend was declared. These board minutes take a different format. This is because, for the very first time, they refer to the dividend policy (although they do not describe it). Mr Skerritt signed the minutes of the meeting as a "true record of the meeting", but they were not dated. They record that Mr and Mrs Skerritt were present at the meeting, and then go on to say: "The only item on the agenda was to discuss the declaration of an interim dividend based on the annual accounts for the year ended 31 December 2017, and management information to date, payable on 13 December 2018. Having considered the Company's dividend policy and whether any changes to such policy were required, it was resolved that a dividend of £334.9282 per share be declared on the whole of the issued A Share Capital of the Company. The Secretary has arranged for the Company's accounts to be annotated indicating the funds being made

unreservedly available for the use of the A Shareholders." The dividend declared was £3,181,835.00 and, on 13 December 2018, Mr Skerritt was paid £1,750,000. It appears that Mrs Skerritt, as she had done in previous years, then waived her dividend of £1,432,835.

134. Mr Skerritt was asked in cross-examination to state the dividend policy referred to in these minutes, and he said this: "… in relation to A shares, it's the policy to look at distributing dividends when the company can afford to do so, taking into account … a level of fairness in terms of remuneration; and the policy on B shares was a case of no dividends to be paid on the B shares, but that obviously could change in the future if we decided it was in the company's interest to do so". This was the first time that Mr Skerritt had described a policy on the A shares. Further, it is also a completely different version of the policy to that set out in his solicitors' letter sent less than 2 weeks before trial: see paragraph 36 above. I do not accept Mr Skerritt's evidence in this regard, as it is something he came up with in the witness box. On 13 December 2018, there was no policy in relation to dividends made by the Company's board of directors. It did not exist, and therefore it cannot have been considered at that meeting. Further, and significantly, Ms McGrath, the third director, was not present at that meeting, and there is no evidence at all that she had any knowledge or understanding of the alleged policy.

(iv) Dividend policy: conclusion

135. I am quite satisfied that the Company does not have, and never has had, a dividend policy which has been made by the Company's board of directors. Further, there is no such policy in existence which complies with the requirements of the Special Resolution or the Shareholders Agreement.

2015-2018: Other matters

136. Mr Routledge instructed solicitors in June 2014, who then took the matter up with Mr Skerritt. On 21 November 2014 Mr Routledge received a letter from the Respondents' solicitors, which purported to serve a notice under clause 9.8 of the Shareholders Agreement, in order to use the transfer procedures under clauses 9.2 to 9.8. Mr Routledge's solicitors responded on 27 November 2014 stating that the notice was invalid and, amongst other things, offered to appoint a suitably qualified expert forensic accountant and valuer to determine the fair value of Mr Routledge's shares under clause 9.3. That offer was not accepted. Following correspondence between solicitors in Spring 2015 it was agreed that Mr Routledge would proceed to obtain a valuation with a view to progressing discussions on a without prejudice basis. The letter of 20 May 2015 sent on behalf of the Respondents reiterated the suggestion that there should be a mediation once the valuation had been obtained, and proposed three possible mediators. Mr Routledge then obtained an expert valuation of his shares in the Company from Simon Blake of Price Bailey LLP, one of the three expert valuers that had been proposed by the Company's accountants, Wilson Sandford. This was done in the knowledge of Respondents. The Respondents were supplied with both a copy of the instructions that had been given to Mr Blake and the valuation prepared by Price Bailey LLP itself. Mr Routledge then proposed mediation. However, even though the Respondents had suggested mediation at an earlier stage, they refused to mediate. The Petition was presented on 22 November 2017.

137. By a letter dated 14 May 2018 Mr Routledge's solicitors asked the Respondents' solicitors whether "Skerritt Consultants Ltd has incurred any legal fees or other

expenses in relation to these proceedings". The Respondents' solicitors refused to answer this question at first. On 12 July 2018 the Respondents' solicitors stated "We do not accept your client's position with regard to our client's legal costs. However, to avoid the parties becoming embroiled in unnecessary and potentially expensive satellite litigation, we confirm that the First Respondent, Mr Skerritt, will cover all legal costs going forward in this matter on behalf of the Respondents." Then, on 14 August 2018, the Respondents' solicitors confirmed that Mr Skerritt would "fully reimburse the Company in respect of fees and disbursements it has paid to this firm on behalf of the Respondents". However, on 10 October 2008, £154,271.35 was debited from Mr Skerritt's director's loan account in respect of "legal fees adjustment". That sum remained outstanding by Mr Skerritt to the Company on an interest-free basis until 13 December 2018 when the balance of Mr Skerritt's loan account was set off against an interim dividend of £1,750,000 paid on the A shares on 13 December 2018.

138. The Respondents do not dispute that the Company's money should not have been used to pay the Respondents' legal fees. However, they seek to blame their previous solicitors for allowing the situation to arise in the first place. That, to my mind, does not explain (and Mr Skerritt did not explain in his evidence) why it took the Respondents so long to remedy the problem, once it had been pointed out to them by Mr Routledge's solicitors in May 2018. This is particularly so given that it is well-established that the expenditure of company funds on disputes between shareholders is a misappropriation of assets and breach of duty: *Re Crossmore Electrical and Civil Engineering Ltd* [1989] 5 BCC 37; *Re a Company* (No. 001126 of 1992) [1993] BCC 325. Nevertheless, the Company has now been reimbursed in full in respect of these costs, together with interest.

CONCLUSION

139. The Company, under the effective control of Mr Skerritt, has never paid a dividend on the B shares. That is a breach of the right attached to those shares, and therefore unfair. The non-payment of dividends on the B shares is, and has been, obviously prejudicial to Mr Routledge, who has been deprived of the income he should have received on his shares. That unfairly prejudicial conduct is continuing. Further, at no point have Mr and Mrs Skerritt given any consideration, let alone proper consideration, to paying dividends on the B shares and, if they had done so in accordance with their duties as directors, they would or should have recognised that continuing with the practice whereby dividends were paid solely on the A shares and nothing at all was paid on the B shares was unfair and unreasonable to Mr Routledge. It is plain that Mr Routledge's rights and interests as a member of the Company have been completely disregarded by Mr and Mrs Skerritt, and that situation is on-going.

140. In relation to the key issues at trial identified at the start of this judgment, I have reached the following conclusions. First, Mr Skerritt did not tell Mr Routledge that he would never be paid a dividend in respect of the B shares before the parties entered into the share purchase agreement in 2005. Second, the effect of the Special Resolution is that, if no policy on dividends was adopted by the board of directors, there is no basis for treating the A shares and the B shares differently in respect of dividends. Third, the board of directors did not at any time after 12 April 2005 (the date Mr Routledge acquired his shares) adopt any dividend policy within the meaning of the Special

Resolution. The consequence of this is that the A shares and the B shares rank *pari passu* in respect of dividends.

141. Fourth, there was no common understanding and convention of the shareholders that there would be no dividends paid on the B shares and that that was the dividend policy within the meaning of the Special Resolution. This is because, before he entered into the share purchase agreement in 2005, Mr Routledge was never told by Mr Skerritt that he would never be paid a dividend on the B shares. Further, Mr and Mrs Skerritt were both directors of the Company, and Mr Skerritt knew, and Mrs Skerritt ought to have known, that there was no policy in relation to dividends made by the Company's board of directors.

142. Fifth, Mr and Mrs Skerritt have breached their duties as directors in a number of different ways. First of all, they have failed to adopt and adhere to a valid board policy on dividends, as required for the purposes of the Special Resolution and the Shareholders Agreement. Second, they failed to act in accordance with the Company's constitution, and caused dividends to be paid otherwise than in accordance with a valid dividend policy. Third, by failing to adopt a valid dividend policy, they failed to take into account the need to act fairly between members of the Company. Fourth, by failing to address the question of board policy on dividends for the purpose of the Special Resolution and Shareholders Agreement, they failed to exercise reasonable care, skill and diligence.

143. Sixth, between 2005 and 2014 Mr Routledge did accept or acquiesce in a situation in which dividends would not be paid on the B shares no matter how profitable the Company was. However, that acquiescence ceased on 21 February 2014, when he wrote to Mr Skerritt complaining about the situation. Since the start of 2014 dividends in the sum of £11,018,522 have been declared on the A shares (of which over £6.8 million has been paid to Mr Skerritt and £281,250 paid to Mrs Skerritt). No dividends have been declared on the B shares, and there is no board policy on dividends. The acquiescence which has been established does not bar the relief sought by Mr Routledge. I also do not consider that he delayed in the issue of his petition.

144. Therefore, there has been unfairly prejudicial conduct to which Mr Routledge is entitled to relief. As this trial was concerned with liability only, I will hear from the parties as to the precise form of relief.