Neutral Citation Number: [2020] EWHC 2913 (Ch)

Case No: CR-2011-006928

IN THE HIGH COURT OF JUSTICE
BUSINESS & PROPERTY COURTS OF ENGLAND & WALES
INSOVLENCY & COMPANIES LIST (ChD)

IN THE MATTER OF SOLID HOMES LIMITED (IN LIQUIDATION)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

Rolls Building
London, WC2A 2LL

Date: 03/11/2020

Before :

INSOLVENCY AND COMPANIES COURT JUDGE BURTON

- -

Between :

(1) PAUL ATKINSON	**Applicants**
(2) GLYN MUMMERY	
(as joint liquidators of Solid Homes Limited)	
- and -	
(1) RODNEY ADU KINGLSEY	
(2) SHARON MARIA SMITH	**Respondents**

- -
- -

Giselle McGowan (instructed by **Francis Wilks & Jones**) for the **Applicants**
Richard Ascroft (instructed as direct access counsel) for the **Second Respondent**

Hearing dates: 21 and 22 January 2020

- -

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.

COVID-19: This judgment was handed down remotely by circulation to the parties' representatives by email. It will also be released for publication on BAILII and other websites. The date and time for hand-down is deemed to be 11.30am on 3 November 2020

.....

INSOLVENCY AND COMPANIES COURT JUDGE BURTON

Insolvency and Companies Court Judge Burton :

Introduction

1. In November 2016, the joint liquidators of Solid Homes Limited commenced these proceedings against the First and Second Respondents as former directors of the Company, seeking to recover £83,000 which the First Respondent procured to be paid by the Company to a third party. Having learned that a bankruptcy order had been made against the First Respondent on 13 September 2016 the Liquidators have not pursued their claim against him.

2. The Second Respondent, Ms Smith did not file Points of Defence. On 19 May 2017, Registrar Derrett summarily determined the application, declared that Ms Smith had breached her duties to the Company pursuant to sections 172 and 174 of the Companies Act 2006 ("CA06") and ordered her to pay £83,000 plus interest and costs.

3. Ms Smith applied to set aside the order of Registrar Derrett on the basis that she had moved home, was not aware of the application having been issued and had a defence to it. The order was set aside on 17 November 2017.

4. On 3 May 2018, the Liquidators were granted permission to amend their Points of Claim to include claims in respect of two further payments.

5. By their amended claim, the Liquidators now seek relief in respect of three payments made by the Company:

    i) The original payment of £83,000 made by banker's draft drawn on the Company's account at National Westminster Bank on or about 22 January 2011. The draft was made out in favour of Lonyo Ifale and cashed on or about 24 January 2011. Throughout the trial, this was referred to as the First Payment and I shall use the same term.

    ii) An on-line payment made on 20 January 2011, from the Company's main bank account with HSBC plc to the Second Respondent in the sum of £60,000 (the "Second Payment"); and

    iii) A further payment made by banker's draft, drawn on the Company's main HSBC account on or about 24 January 2011 in favour of the Second Respondent, for £31,126 ("Third Payment").

6. The Liquidators' primary case is that no consideration was given for all three payments. In failing to put in place arrangements to prevent the First Respondent from making the First Payment, Ms Smith breached her duties to the Company pursuant to sections 172 and 174 CA06 and should be liable to contribute the amount lost by the Company as a result. In making the Second and Third Payments to herself for no consideration, Ms Smith breached her duties pursuant to sections 171 and 172 CA06.

7. Ms Smith claims that the First and Second Payments were dividend payments authorised to be paid unconditionally to herself and conditionally to the First Respondent. The Liquidators say that if that is the case, they were unlawful distributions made in contravention of the Company's Articles of Association and were

paid in breach of the Second Respondent's duties to the Company because at the relevant time, the Company did not have sufficient profits available to make a distribution to its shareholders.

8. Ms Smith states that the Third Payment was due from the Company to a partnership operated by by her former partner. She remitted the funds to the partnership on behalf of and for the benefit of the Company.

Background

9. The Company was incorporated in September 2001. The First Respondent was appointed a director on incorporation. He resigned as a director on 11 October 2004 and was re-appointed on 10 October 2006. Ms Smith was appointed a director on 1 September 2003. Both remained directors until the Company entered administration on 20 September 2011.

10. Ms Smith describes the Company's activities during its trading period as (i) acting as a letting agency for various private landlords; (ii) renting out properties owned by the Company; and (iii) undertaking property development works at sites acquired for that purpose.

11. In her fourth witness statement, she states:

> "Differences in opinion between R1 and me, predominantly arising out of managerial styles and imbalanced workloads, resulted in both of us reaching the conclusion around mid-Spring 2010 that this would probably be our last year in business together. The trigger that fast forwarded that decision was when our main customer, London Borough of Lambeth, advised us in July 2010 that, due to central governmental pressure, they had to reduce the rental income we were receiving from them, thus potentially placing the Company in a future loss-making position. It is important to note that as properties were on 2-5 year leases, the full financial impact would not start to kick in until July 2012".

12. The relationship between the directors deteriorated. On 1 September 2010, a meeting took place between the First Respondent and the Company's accountants, McBrides. Ms Smith was not present. A file note of the meeting prepared by one of the accountants, Mr Moleshead, is exhibited to Mr Atkinson's second witness statement. It records that the First Respondent requested the meeting to discuss a letter received from HMRC regarding a tax enquiry. The First Respondent is reported to have brought the accountants up to date with the Company's affairs, its proposed legal action against the local authority for altering the terms of its contract with the Company, his perception that there was limited scope for selling the business when its future was so uncertain, and an estimate of the value of the equity it was trying to realise by selling substantial fixed assets. The note records that those attending the meeting considered whether the Company should be put into liquidation or "whether there was a future in trying to have an orderly wind-up of the company". The minutes of the meeting record:

> "It is apparent Rodney needs some specialist advice and it was agreed that we would try to make an introduction to Paul Atkinson of FRP who is an insolvency practitioner known to John".

13. The Company continued to trade. Ms Smith claims that in December 2010 she held a meeting with the First Respondent at the Hilton Hotel in Croydon (the "December 2010 Meeting") to discuss realising the Company's investment properties, paying off its creditors, making distributions to themselves as shareholders and then winding down the business.

14. The net proceeds of sale from a development at Ashmore Road were received by the Company in January 2011. Just over a week later, the First Payment was withdrawn in the form of a banker's draft from the Company's account at NatWest Bank, known as the "Development Account" and Ms Smith transferred the Second Payment to herself from the Company's HSBC account.

15. It is Ms Smith's case that the circumstances surrounding the First Payment made her relationship with the First Respondent much worse. She froze the Company's bank account and did not unfreeze it until dual signatory requirements were put on the bank mandate. She claims that thereafter, when the First Respondent refused to permit her to pay certain creditors, it became untenable for them to continue to wind down the business together.

16. She first met the First Applicant, Mr Atkinson in March 2011. In June 2011 she signed the relevant forms to put the Company into administration but following the First Respondent's refusal to sign the papers, ultimately it did not enter administration until September 2011. The administration was converted to a liquidation on 31 August 2012.

Relevant legal principles

17. The Liquidators claim that Ms Smith breached her duties under sections 172 and 174 CA in making the First Payment and sections 171, 172 and 174 in making the Second and Third Payments.

18. **Section 172 CA06 (Duty to promote the success of the company)** provides:

> "(1) A director of a company must 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):
>
> (a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees,
> (c) the need to foster the company's business relationships with suppliers, customers and others …
>
> (3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company."

19. The duty imposed by section 172 comprises both subjective and objective elements. This was explained by Jonathan Parker J in *Regentcrest Plc (in liq) v Cohen [2001] B.C.C. 494* at [120]:

> "The question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director's state of mind. No doubt, where it is clear that the act or omission under challenge resulted in substantial detriment to the company, the director will have a harder task persuading the court that he honestly believed it to be in the company's interest; that does not detract from the subjective nature of the test."

20. In *Re HLC Environmental Projects Ltd [2013] EWHC 2876 (Ch); [2014] B.C.C. 337* Mr John Randall QC sitting as a deputy high court judge explained that the general principle of subjectivity is subject to three qualifications. The first applies where a company is insolvent or "doubtfully solvent":

> "(a) Where the duty extends to consideration of the interests of creditors, their interests must be considered as "paramount" when taken into account in the directors' exercise of discretion. …
>
> (b) … the subjective test only applies where there is evidence of actual consideration of the best interests of the company. Where there is no such evidence, the proper test is objective, namely, whether an intelligent and honest man in the position of a director of the company concerned could, in the circumstances, have reasonably believed that the transaction was for the benefit of the company. …
>
> (c) Building on (b), I consider that it also follows that where a very material interest, such as that of a large creditor (in a company of doubtful solvency, where creditors' interest must be taken into account), is unreasonably (i.e. without objective justification) overlooked and not taken into account, the objective test must equally be applied. Failing to take into account a material factor is something which goes to the validity of the directors' decision-making process. This is not the court substituting its own judgment on the relevant facts (with the inevitable element of hindsight) for that of the directors made at the time; rather it is the court making an (objective) judgment taking into account all the relevant facts know or which ought to have been known at the time, the directors not having made such a judgment in the first place".

21. **Section 174 (Duty to exercise reasonable, care, skill and diligence)** provides:

> "(1) A director of a company must exercise reasonable care, skill and diligence.
>
> (2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with:

> (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by a director in relation to the company, and
>
> (b) the general knowledge, skill and experience that the director has."

22. Mr Justice Briggs (as he was) explained the subjective and objective elements of this test in *Lexi Holdings plc (in administration) v Luqman and others* [2008] 2 BCLC 725:

> "The objective test sets the basic standard. It is no excuse for a director to say that, in fact, she did not have the general knowledge, skill or experience reasonably to be expected of a person carrying out her appointed functions. The subjective test potentially raises the standard by reference to any greater general knowledge, skill or experience which the particular director actually has. "

23. Section 171 CA06 (Duty to act within powers) provides:

> "A director of a company must:
> a) act in accordance with the company's constitution, and
> b) only exercise powers for the purposes for which they were conferred".

24. The Liquidators have provided evidence of the Company's money being paid to Ms Smith. In *Re Idessa (UK) Ltd (in liquidation)* [2012] 1 BCLC 80, Lesley Anderson QC sitting as a Deputy Judge of the High Court explained that this results in the burden of proof shifting from an applicant to a respondent. At paragraph 28 she states:

> "I am satisfied that whether it is to be viewed strictly as a shifting of the evidential burden or simply an example of the well-settled principle that a fiduciary is obliged to account for his dealings with the trust estate, that Mr Aslett is correct to say that once the liquidator proves the relevant payment has been made the evidential burden is on the respondents to explain the transaction in question".

25. *Toone v Robbins* [2018] BCC 728 is authority for the proposition that once the Court has decided that absent clear evidence one way or the other, an issue must be determined by reference to the burden of proof, and where there is no dispute that the payment had been made to the directors, the benefit of any doubt must be given to the company's liquidators and not to the recipients of the money.

The statutory requirements relating to distributions

26. If the Court accepts Ms Smith's case, that the First and Second Payments were dividends, the Liquidators claim that they were unlawful.

27. For the purposes of Part 23 CA06, a dividend is a "distribution", defined at section 829 to mean, subject to various exceptions, every description of distribution of a company's assets to its members, whether in cash or otherwise.

28. **Section 830 (Distributions to made only out of profits available for the purpose)** provides (so far as relevant):

> "(1) A company may only make a distribution out of profits available for the purpose.

(2) A company's profits available for distribution are its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made".

29. **Section 836 (Justification of distribution by reference to relevant accounts)** provides:

"(1) Whether a distribution may be made by a company without contravening this Part is determined by reference to the following items as stated in the relevant accounts –

(a) profits, losses, assets and liabilities;

(b) provisions of the following kinds-

(i) where the relevant accounts are Companies Act accounts, provisions of a kind specified for the purposes of this subsection by regulations under section 396;
(ii) …

(c) share capital and reserves (including undistributable reserves).

(2) The relevant accounts are the company's last annual accounts, except that

(a) where the distribution would be found to contravene this Part by reference to the company's last annual accounts, it may be justified by reference to interim accounts, and

(b) …

(3) The requirements of –

section 837 (as regards the company's last annual accounts),
section 838 (a regards interim accounts)
. . .
must be complied with, as and where applicable.

(4) If any applicable requirement of those sections is not complied with, the accounts may not be relied upon for the purposes of this Part and the distribution is accordingly treated as contravening this Part".

30. **Section 837 (Requirements where last annual accounts used)** provides:

"(1) The company's last annual accounts means the company's individual accounts-

a) that were last circulated to members in accordance with section 423 (duty to circulate copies of annual accounts and reports)

b) …

(2) The accounts must have been properly prepared in accordance with this Act, or have been so prepared subject only to matters that are not material for determining (by reference to the items in section 836(1)) whether the distribution would contravene this Part.

(3) Unless the company is exempt from audit and the directors take advantage of that exemption, the auditor must have made his report on the accounts".

31. Section 851 CA06 provides that the distribution provisions of Part 23 CA06 are without prejudice to any rule of law restricting the sums out of which a distribution may be made. The interaction between Part 23 and the common law is helpfully set out in Buckley on the Companies Act – Division 13, at paragraphs 16 and 17:

> "[16] Part 23 is a largely self-contained code governing distributions to members, but it is not exclusive. The CA 2006, s851(1) provides that it is 'without prejudice to any rule of law restricting the sums out of which, or the cases in which, a distribution may be made' and the CA 2006, s852 contains a similar saving as regards enactments and provisions in a company's articles. The saving in s851(1) has the effect of preserving the long-standing prohibition on distributions out of capital, which was re-affirmed by the Supreme Court in *Progress Property Co Ltd v Moore* [2010] UKSC 55.
>
> [17] A company making a distribution must therefore comply with both the provisions of Part 23 and the common law rule against making a distribution out of capital. An essential difference is that under Part 23 the determination of profits out of which distributions may be made is by reference to the figures appearing in the relevant accounts, whereas the common law rule is applied by reference to actual values at the date of distribution. In most cases, compliance with Part 23 should ensure compliance with the common law rule. Where, however, there has been a material adverse change in the financial condition of the company since the last accounts, a distribution may be unlawful under the common law rule without contravening Part 23 (*Shaker v Al-Bedrawi* [2002] EWCA Civ 1452)."

Documentary evidence

32. The task of fact finding in this case was challenging due to a lack of documentary evidence.

33. In *Re Mumtaz Properties Ltd* [2011] EWCA 610 directors facing claims for misfeasance and to repay sums said to be due under their loan accounts had refused to deliver up the Company's books and records to its liquidator. Arden LJ stated at paragraph 16:

> "The evidence of the liquidator established a prima facie case and, given that the books and papers had been in the custody and control of the respondents to the proceedings, it was open to the judge to infer that the liquidator's case would have been borne out by those books and papers.
>
> [17] Put another way, it was not open to the respondents to the proceedings in the circumstances of this case to escape liability by asserting that, if the books and papers or other evidence had been available, they would have shown that they were not liable in the amount claimed by the liquidator. Moreover, persons who have conducted the affairs of limited companies with a high degree of informality, as in this case, cannot seek to avoid liability or to be judged by some lower standard than that which applies to other directors, simply because the necessary documentation is not available".

34. When Ms Smith wrote to the Liquidators' solicitors in September 2018 asking to inspect the Company's records, she stated that she would want to review its SAGE accounting records. The Liquidators initially encountered an IT problem but that was resolved sufficiently to enable Ms Smith to attend their offices on 10 September 2018. In her fourth witness statement she states:

> "It was my intention to produce a range of key reports to support my argument with regards to creditor balances. However, I was astonished to discover that the SAGE records had been uploaded to a laptop for my use that day with data that ends in 2006. I do not know how this could be as this is the same accounting suite used by the Company's former accountants to prepare the final accounts up to 2009 and used to record all payments right up to September 2011".

35. She subsequently received an email stating that an IT expert had been able to work with SAGE and "as a result been finally able to open and access the new backup" and offering her the opportunity to view it. She was told that a USB drive had been found in the drawer of a desk previously occupied by Mr Spencer who had day to day management of the Company's administration and liquidation but who has since left the Liquidators' firm. She is recorded in the minutes of a meeting held with the Liquidators' staff on 25 September 2012 to have said that she could not understand why a USB stick would have included SAGE records as they would all have been on the hard drives of the computers taken from the Company's offices by the Liquidators' staff in October 2012. Ms Smith states that when she went to reinspect the SAGE records, whilst they were now more up-to-date, the data appeared incomplete and that as a result, she was not able to produce the reports which she intended to provide to the Liquidators.

36. Mr Atkinson refers in his second witness statement to copies of the SAGE generated Fixed Asset Record and balance sheet for the years ended March 2009 to March 2012 which, he states, show that the Company's fixed asset position did not change during that period. However, he did not put the SAGE records in evidence.

37. Ms Smith's evidence is that in anticipation of the December 2010 Meeting, she prepared a financial statement and a schedule of the Company's creditors and that she also made hand-written notes during the meeting. None of these documents were located among the records held by the Liquidators and having moved home since the payments were made, she has not been able to locate a copy.

38. There is no criticism in this case, as there was in *Mumtaz*, that Ms Smith intentionally withheld documents from the Liquidators. The absence of documentary evidence might be explained by the Company failing to keep full records, or, as Ms Smith submits, that in the six years which passed between handing them over to the Liquidators and the Liquidators amending the proceedings to include claims in respect of the Second and Third Payments, documents held by her personally were lost or destroyed during her house move and something happened to the SAGE records such that the version latterly made available to her, was not as complete as it should have been.

39. The approach of the trial judge in *Mumtaz* was to seek to test the evidence by reference to both the contemporary documentary evidence and its absence. I shall adopt the same approach, although in the circumstances of this case, where there is no clear explanation for the lack of documents, shall attach less weight to the absence of documents than was appropriate in *Mumtaz.*

Witness evidence

40. The witness evidence on which the parties relied at trial was set out, for the Liquidators in statements by Mr Atkinson and his solicitor, Richard Ludlow and for the Second Respondent in Ms Smith's four witness statements.

41. Mr Ludlow's evidence was given in support of the Liquidator's application in January 2018 to include the Second and Third Payments in their claim against Ms Smith. He explained that following service of her Points of Defence, the Liquidators' senior investigations manager noted that additional payments were made to Ms Smith around the same time that the First Payment to Mr Ifale was made.

42. Mr Atkinson and Ms Smith appeared at trial and were cross-examined on their evidence.

43. By the time of the trial, almost 9 years had passed since each of the Payments were made. Both witnesses would be forgiven for having, at best, a hazy memory of some of the details concerning the issues in dispute.

44. Mr Atkinson appeared to me to be an honest witness. Despite being one of the two named liquidators in the case and the "lead liquidator" his day-to-day involvement with the case was limited. Most of the work was undertaken by his staff, key members of which have since left the firm. More often than not, his replies to questions posed during cross examination were to the effect that he had not made enquiries or done or investigated something in particular, but that his staff may have made the enquiry or undertaken the relevant action or investigation. He was unable to recollect almost any detail other than by reference to his interpretation of the documents in evidence. He was unable to say when his staff analysed the SAGE records. He was unable to say whether staff questioned the First Respondent about a cluster of debts which, according to Ms Smith, she could not pay because he refused to countersign the relevant cheques. He confirmed that he did not make any enquiries of the Company's accountants or its directors regarding discrepancies between the Company's balance sheet and its SAGE records but he was unable to say whether his staff had made any such enquiries. He confirmed that a statement in his second witness statement, that if alleged overpayments from Lambeth Borough Council ("LBC") were taken into account in the

Company's last accounts, they would have eroded the profits available for distribution, was speculative and that he did not make the necessary enquiries to confirm or clarify the position. He emphasised, however, that he had prefaced the statement by saying "if" the payments had been taken into account.

45. Despite the large gaps in his knowledge, I have no doubt that Mr Atkinson did his best to assist the Court to the best of his limited recollection.

46. I consider that in the main, Ms Smith was a truthful witness. She readily accepted that the notes which she said she had prepared in advance of the December 2010 Meeting should have been included in the Company's books and records and that the Company hit a period when it was struggling with cash flow. She insisted that it nevertheless did not run out of money. However, her answers to some of the questions posed during cross-examination were guarded: "yes that is my evidence" and her replies to some questions were simply not credible. One example highlighted by Ms McGowan, arose when Ms Smith refused to accept that the Company frequently failed to file its annual accounts on time. She insisted that this had happened on only two occasions, but the documentary evidence clearly contradicts this. Another example arose when asked about the Company being chased by creditors for overdue payments. She sought to explain this by reference to the period when the First Respondent was refusing to countersign cheques. However, several of the debts in question, clearly pre-dated that period.

47. In closing, Ms McGowan gave ten examples where she considered Ms Smith's evidence not to be credible. In some of the instances, I do not agree with Ms McGowan's interpretation of the evidence. She said that Ms Smith refused to accept responsibility for the figures included in the note Mr Atkinson prepared of his meeting with her on 2 March 2011. Ms McGowan said that the figures could only have been given to him by Ms Smith and that her refusal during cross-examination to accept that the note demonstrated that the Company was clearly insolvent, demonstrated a willingness on her part to mislead the Court. Whilst I accept that Ms Smith almost certainly provided the figures to Mr Atkinson, the note was not prepared by her and she does not appear to have been asked to confirm that it was accurate. She said in cross-examination that it was not accurate and that it omits to include one of the Company's properties. She was adamant that the figure provided for overpayments by LBC would have been largely cancelled out by the underpayment figure. I do not consider that the answers which she gave to this line of questioning suggested she was seeking to mislead the Court.

48. Another example given by Ms McGowan concerned Ms Smith's insistence that LBC's overpayments to the Company did not render it insolvent at the time when the First and Second Payments were made. Ms McGowan referred to the Company's main customer, LBC changing its terms to reduce the Company's income by 20% putting the Company into a "potentially loss-making position". Ms Smith said "No" before being reminded that she had used that phrase in her own witness statement. I do not accept that this demonstrates an intention on Ms Smith's part to mislead the Court. In my judgment, she was tripped up during cross-examination, not realising counsel had moved from talking about immediate insolvency to future insolvency – which Ms Smith always accepted would happen if the Company were not wound up before the impact of LBC's changes came into effect.

The First Payment

49. It was common ground between the Liquidators and Ms Smith that the First Payment (in favour of Mr Ifale) was made by the First Respondent and that Mr Ifale appears to have given no consideration for the payment.

50. During a telephone call on 19 November 2013 between the First Respondent and a member of the Liquidator's staff, Anna Whitlock, the First Respondent informed Ms Whitlock that Mr Ifale had worked as a contractor at a property situated in Ashmore Road, Maida Vale.

51. Ms Smith states that she had never heard of Mr Ifale, and that the work for which Mr Ifale is said to have been paid, was undertaken by and invoiced by Poseidon Contractors Limited. Ms Smith provided a copy of Poseidon's invoice to support this.

52. In her letter to the Liquidators dated 4 July 2014, Ms Smith stated:

> "This money was an unauthorised withdrawal by Mr Adu-Kinglsey as he did not have my consent and this contributed significantly to the escalation of our dispute. The withdrawal was signed by Mr Adu-Kingsley and was allowed to go through as in the mayhem that was taking place at the time we failed to put joint signatories on non-operational accounts which resulted in Mr Adu-Kingsley stealing the company funds without my consent. The withdrawal had only one signatory and until now I had always assumed the draft was made payable to Mr Adu-Kingsley".

53. During cross-examination she later said that when using the word "mayhem" she "probably exaggerated a bit".

54. In her Amended Points of Defence Ms Smith avers that from at least 2004, the Respondents were remunerated by a mixture of salary and dividends, that they took periodic drawings from the Company in anticipation of the declaration and payment of a final dividend at the year end. She said that at the December 2010 Meeting, they agreed that subject to the First Respondent providing a breakdown of his expense drawings, each of them would be entitled to the equivalent of £83,000 in dividends for the period ending 31 March 2011. She averred that any payment in respect of this dividend would only be made following the sale of the Company's property at Ashmore Road. However, when she discovered that he had made the payment to himself (or so she thought at the time) without her authority, from a non-operational account and without providing the required breakdown of his drawings, she was annoyed with him.

55. During cross-examination, Ms Smith was asked whether she considered it was in the Company's best interests to continue to allow the First Respondent to have unrestricted access to the Company's accounts. She replied: "Yes" and conceded that she could have put in place new banking mandates, but insisted that she saw no reason to do so because she had no reason to believe that the First Respondent would make use of the accounts; they only disagreed on the way forward for the Company.

56. The Liquidators' primary case against Ms Smith in relation to the First Payment is that the working relationship between her and the First Respondent had broken down to such an extent that she should have put in place arrangements to prevent him from

dealing with the Company's assets without her authorisation, including preventing him from drawing a banker's draft from a Company account without her authorisation. They state that in failing to do so, she breached sections 172 (duty to promote the success of the company) and 174 (duty to exercise reasonable care, skill and diligence) CA06 as a consequence of which the Company suffered a loss equal to the value of the banker's draft, namely £83,000.

57. Counsel disagree regarding the questions which the Court should consider when approaching this part of the Liquidator's claim. Mr Ascroft relies upon the decision of Sir Andrew Morritt C in *Lexi Holdings plc (in administration) v Luqman and ors* [2009] 2 BCLC 1 which concerned the consequences for M and Z, the fellow directors of Shaid Luqman (who were also his sisters) once it was discovered that he had misappropriated more than £53 million from Lexi. At first instance, Briggs J held that the sisters should have informed their fellow directors on Lexi's board of what they knew of Mr Luqman's past criminal convictions. He rejected submissions that they should have gone further by preventing him from becoming a director of the company or from operating the company's bank accounts. During the period when Mr Luqman's misappropriations occurred, Lexi's accounts recorded a directors' loan account held in Z's and his name. At first instance, Briggs J concluded that the loan account was bogus.

58. On appeal, Sir Andrew Morritt held that the loan account was significant in demonstrating that Mr Luqman's dishonesty was continuing. He held that as the account was also held in Z's name, she should have known about it shortly after her appointment as a director and "could not consistently with her duty as a director, do nothing". In his judgment, if Z had informed Lexi's auditors, they could not have approved unqualified accounts. That would have prevented further facilities being granted to Lexi which, in turn, would have deprived the company of the funds subsequently misappropriated by Mr Luqman.

59. Mr Ascroft submits that it is not uncommon for all directors in a small company to have unilateral access to the company's accounts, particularly when one is working primarily from the company's offices and the other is out in the field. Adopting the approach taken by the Chancellor, he submitted that the Court should consider the First Payment by posing the following four questions:

    i) What did Ms Smith know immediately before the First Respondent caused the First Payment to be made (and more specifically, was she put on notice that he might (on the Liquidator's case) misapply the Company's money;

    ii) In light of that knowledge, what arrangements (if any) should Ms Smith have made?

    iii) Would such arrangements have been effective to have prevented the First Payment:

    iv) If yes, and the Company thereby suffered loss in consequence of Ms Smith's failure to act, should she be relieved in liability (in whole or in part) under s 1157 CA06?

60. Ms McGowan does not accept that the relevant test includes a requirement that Ms Smith should have been put on notice that the First Respondent might misapply the Company's money. She submitted that the Court should approach the question in two stages: first considering the circumstances prevailing at the time and secondly to consider what steps Ms Smith should have taken in those circumstances.

61. As stated by Jonathan Parker J in *Regentcrest Plc (in liq) v Cohen* (set out at paragraph 19 above) when considering an alleged breach of section 172, the subjective question is whether the director honestly believed that his act or, in this case, her omission, was in the interests of the company. The issue concerns Ms Smith's state of mind.

62. The subjective test only applies where there is evidence of actual consideration of the best interests of the company.

63. As the alleged breach by Ms Smith of section 172 in this case comprises an omission rather than an act, it is perhaps not surprising that beyond her statement that she did consider creditor claims, there is no other evidence of her having considered what was in the interests of the company. In the absence of evidence, the proper test is objective. In light of the nature of the omission and the very limited evidence described above, I consider it appropriate for the Court in this case, to apply an objective test.

64. The circumstances which Ms McGowan urged the Court to consider for the purposes of the objective test include:

    i) the answers Ms Smith gave in her director's questionnaire:

    > "The relationship between Rodney Adu-Kinglsey and I had started to deteriorate early in 2010. We differed on a number of key managerial issues and the strategic direction of the company. I was becoming increasingly exasperated by the imbalance in our respective workloads and day-to-day management of the company";

    ii) the First Respondent's report to the company's accountant at the meeting on 1 September 2010 of the deterioration in his working relationship with Ms Smith; and

    iii) Ms Smith's own description in her letter to the Liquidators dated 4 July 2014, of the difficulties between them causing "mayhem".

65. In these circumstances, the Liquidators say, an honest and intelligent person in Ms Smith's position would not have left the First Respondent in a position of trust and an obligation arose to restrict his unfettered access to the Company's accounts.

66. For the purposes of section 174 CA06, Ms McGowan accepts that directors will not be held to be in breach of the duty owed pursuant to section 174 simply for trusting other persons who are in a position of trust for the purpose of managing the company but, she submits, a director's reliance on co-directors cannot be unquestioning. They are under a duty to ensure that sufficient controls are in place so that abuses can be quickly identified and so that the company's board of directors is always in a position to guide and monitor the management.

67. Ms McGowan relies on *Dorchester Finance Co Ltd and another v Stebbing* [1989] BCLC 498 where two non-executive directors were found to have been negligent in failing to carry out their duties as directors by signing blank cheques which allowed the director with day-to-day management of the company to act as he pleased. In this case, the First Respondent did not even need to be given signed, blank cheques: he already had immediate access to the Company's accounts, which Ms McGowan said was "as good as a blank cheque".

68. Ms Smith's uncontradicted evidence was that the First Respondent had never previously misapplied any of the Company's money, used the Development Account for the purposes of making any payments nor otherwise caused the Company to make payments in breach of duties he owed to the Company.

69. It was not part of the Liquidators' case that Ms Smith breached her duties to the Company by allowing such unilateral access from the outset. Instead, they rely on the deterioration of the relationship between the Company's directors to justify their allegation that she should have taken unspecified steps to terminate his access to the accounts.

70. For the purposes of considering the matters before the Court in this case, I interpret the approach set out by John Randall QC in *Re HLC Environmental Projects Ltd* to mean that the Court must decide whether an intelligent and honest person in the position of a director of the Company could, in the circumstances, reasonably have anticipated that steps should have been taken, at some stage before the First Respondent obtained the banker's draft in favour of Mr Ifale, to prevent him from having unrestricted access to the Company's accounts. This, it seems to me, does not impose a requirement for the Court to determine whether Ms Smith was on notice that the First Respondent might misapply the Company's money. However, any actual knowledge or notice of such a risk would be part of the factual matrix and circumstances to be taken into account when considering, objectively, whether the director's actions or omissions amounted to a breach of section 172.

71. In my judgment, the Liquidators' primary case relies too heavily on the benefit of hindsight and fails realistically to take into account the circumstances surrounding the Company's management at the time. Applying the objective test from *Re HLC Environmental Projects Ltd* and considering the circumstances in the period leading up to the First Respondent obtaining a draft in favour of Mr Ifale, there is no evidence to support the Liquidators' allegation that the serious disagreement between the Company's directors regarding the future of the Company and how it should be managed, gave rise to such an evaporation of trust between them that an intelligent and honest person in Ms Smith's position became obliged to restrict his access to the Company's bank accounts. I do not accept the analogy drawn by Ms McGowan with the blank cheques signed by directors in *Dorchester*. Setting up a company's bank mandates, from its inception, is inherently different from a situation where those required to authorise specific payments by signing cheques, relinquish that authority by signing blank cheques.

72. I reject Ms McGowan's submission that if Ms Smith had considered the interests of the Company or its creditors, she could not honestly have believed that allowing the First Respondent an unfettered ability to deal with the Company's money was in the best interests of the Company or its creditors. The breakdown in the relationship between

the Respondents arose over a period of time and yet he had never previously abused his right, as a director, to access the Company's bank accounts. In my judgment, the fact that the Respondents were unable to agree on the Company's future did not automatically lead to an obligation on Ms Smith to terminate her fellow director's access to the Company's accounts. Moreover, the evidence shows that once such measures were put in place (following the First Respondent's drawing of the banker's draft) disagreements arose between the directors as to which creditors could be paid. Ms Smith's evidence, supported by the documentary evidence, is that the dual-signing requirement led to a worsening of the situation for creditors.

73. In any event, I would hold that she should be relieved of liability in relation to the full value of the First Payment pursuant to s 1157 CA06. Considering the Liquidators' primary case, there is no claim that she acted other than honestly in relation to the First Payment. She did not benefit in any way from the banker's draft. Once she discovered the money had been taken from the account, she took steps immediately to prevent it from happening again. In the light of the circumstances as I have interpreted and described them, in my judgment, Ms Smith acted reasonably. Whether in failing or in deciding not to restrict the First Respondent's access to the accounts, she ought fairly to be excused.

The Second Payment

74. The issues to be determined in relation to the Second Payment are:

    i) Whether it was a payment for no consideration or whether, as Ms Smith says, the First and Second Payments were dividends; and

    ii) If dividends whether they were unlawful because:

        a) they were paid in breach of the provisions of the Company's Articles of Association; and

        b) the Company did not have sufficient distributable profits for them to be paid.

75. The Liquidators rely on the following factors in support of their submission that the Court should prefer their case, that the First and Second Payments were made for no consideration:

    i) the banker's draft comprising the First Payment was made out to Mr Ifale, not the First Respondent;

    ii) during a telephone call with one of the Liquidators' staff, the First Respondent made no mention of the First Payment being a dividend, but rather, claimed that Mr Ifale was a contractor;

    iii) the amounts which Ms Smith claims were agreed at the December 2010 Meeting to be paid as dividends conflict with the dividend payments referred to in a letter dated 19 December 2011 from her solicitors. Their letter to the Liquidators' solicitors state that the Respondents agreed payments of

£51,714.20 to the First Respondent and £48,714.30 to Ms Smith for the period 4 November 2010 to 31 January 2011;

iv) the Company's books and records include no evidence of the December 2010 Meeting and she has failed to produce any evidence that it took place and failed to provide any documents or financial calculations which she states they considered at the meeting;

v) Ms Smith's explanation for the differing amounts paid to each shareholder relies upon the value of cars, the benefit of which she states she had already received. However, she has failed to produce any evidence of this; and

vi) Ms Smith claims to have declared the Second Payment in her tax return but the only evidence she provided of her returns was on the day of trial, when she produced only one return, dated 17 April 2013 for the year ended 5 April 2011. That return includes £74,888 for dividends from UK companies (not £83,000) and although it was stated to be based on revised figures, Ms Smith has not produced her original tax return.

76. There is no documentary evidence to explain or justify the Second Payment made by Ms Smith to herself in her position as a director owing fiduciary duties to the Company. The burden of proof is upon her to show that it was a legitimate application of the Company's money and the benefit of the doubt must be given to the Liquidators.

77. The only evidence to support Ms Smith's case that the Second Payment was a dividend, are her own statements: those made in her directors' questionnaire; in the minutes of a meeting with the Liquidators replying to questions pursuant to section 235 of the Insolvency Act 1986; in her letters responding to the Liquidators' enquiries and in her oral evidence given during cross-examination.

78. She has been unable to explain why the First Respondent made no reference to the First Payment being a dividend. Mr Ascroft highlights that it does not appear to be in dispute that the explanation he did provide conflicted with the Company's documentary records. Their business relationship ended badly, and it is perhaps not surprising that she did not choose to call him as a witness.

79. The letter sent by Ms Smith's solicitors referred to total approved dividends of £100,428.60 for the period for November 2010 – 31 January 2011, and that:

> "Our client's amount included the transfer of ownership of a Renault Clio valued at £3500 and a Peugeot 206 valued at £3900 at the time of the transfer. This transfer occurred at the time Solid Homes was solvent. It also amounted to less than 8% of the above-mentioned dividend."

80. During cross-examination, Ms Smith confirmed that CLC's letter was sent on her instructions, but she said that it contained an error. She said the cars were included as part of the payment to her of £84,000 not £48,714.30 and that this latter amount, calculated to January 2011 was at one stage "approved" but in fact, was never taken. The amount which the directors agreed upon and paid, covered the period to 31 March 2011 and came to £83,000.

81. When cross-examined regarding the discrepancy between the sum of £74,888 stated in the tax return produced at trial and the value of the Second Payment (£83,000) Ms Smith said she decided to declare the £60,000 and £15,000 (already received) but not the full £83,000, because she put the additional amount in respect of the cars in her return for the following year. She provided no documentary evidence to support this.

82. Although the return dated 17 April 2013 was based on revised figures, Ms Smith failed to produce her original tax return. When Ms McGowan put to Ms Smith that the figures had only been changed after the Liquidators had challenged the payment, Ms Smith replied that she did not remember.

83. Ms Smith insists that she prepared notes in anticipation of the December 2010 Meeting setting out the values of the properties yet to be sold, the amounts due to be paid to creditors and showing how she arrived at £83,000 to be paid as dividends. She admits that she has not been able to produce a copy.

84. Whilst the benefit of the doubt must go in favour of the Liquidators, the length of time that passed before Ms Smith became aware of the proceedings (when the Liquidators amended their claim to include the Second Payment) render it unsurprising, in my judgment, that she has not been able to locate the notes she claims to have prepared both before and during the December 2010 Meeting. Her solicitors' letter referred to a different distribution but as there was no evidence before me that the amount they referred to was ever withdrawn by either Respondent from the Company's bank account, I accept Ms Smith's evidence that they erroneously referred, on her instructions, to a dividend that was proposed but ultimately not paid.

85. Ms Smith has failed adequately to explain why the cars were not included in the tax return which she latterly produced in evidence but I do not accept the Liquidator's contention that the revised nature of the statement suggests she amended her return to support her case. If that were the case, she might have been more likely to refer to the total figure of £83,000, rather than leave an unexplained discrepancy in an amount similar to the value of the cars.

86. In my judgment, the Company's history of dividends and Ms Smith's consistent statements that the amounts were to be paid as such following the sale of the Ashmore Road development supports a conclusion that the First and Second Payments were dividends and not simply payments for which the Company's two directors and shareholders gave no consideration.

Were the dividends lawful?

87. The Liquidators claim that the dividend payments were in breach of the Company's Articles and comprised unlawful distributions because the Company did not have distributable profits and was insolvent.

88. Pursuant to paragraph 102 of Table A to the Companies (Tables A to F) Regulations 1985 (incorporated into the Company's Articles of Association by Article 1) any dividend had to be approved by an ordinary resolution. Such ordinary resolution must be passed in accordance with the provisions of s281 CA06, either by written resolution or passed to general meeting of which notice (both of the meeting and of the resolution)

had been given and which had been held and conducted in accordance with Chapter 3 of Part 13 CA06.

89. It is not in dispute that there is no evidence in the Company's books and records of such an ordinary resolution having been passed. Instead, Ms Smith relies upon the principle in *In Re Duomatic Ltd* [1969] 2 Ch 365 that where it can be shown that all the shareholders who have a right to attend and vote at a general meeting of the company assent to some matter which a general meeting of the company could carry into effect, that assent is as binding as would be a resolution passed at a general meeting. She asserts that once she and the First Respondent agreed to the First and Second Payments at the December 2010 Meeting, their agreement was as binding as a resolution in general meeting.

90. It is also not in dispute that the principle in *Re Duomatic* only applies if the Company was solvent at the time. The parties disagree where the burden lies to prove solvency/insolvency.

91. Mr Ascroft relies on passages from *Burnden Holdings (UK) Ltd (in liquidation) and anr v Fielding and anr* [2019] EWHC 1566 (Ch) to show that the agreement which Ms Smith claims was reached at the December Meeting in respect of the proposed dividend, constitutes sufficient compliance with article 102.

92. Those passages concern a question of whether the dividend in that case (which was the subject of a written resolution signed on behalf of the sole shareholder) was declared at a properly convened board meeting. In the case before me, there was no members' resolution and I find the passage in *Burnden Holdings* of little assistance.

93. In *Lexi Holdings plc* Briggs J clearly held (at paragraph 193) that it is for a party who seeks to invoke the *Duomatic* principle, that the company was solvent at the relevant time. The provisions of Part 23 governing distributions – the rationale for which is to protect creditors – are not capable of being waived under the *Duomatic* principle.

94. The question of whether the Company was solvent at the time the First and Second Payments were made is at the heart of the Liquidators' claims.

Distribution from available profits

95. The Company's last annual accounts were prepared by the Company's accountants, McBrides for the period ended 31 March 2009. Those accounts disclosed distributable profits of £551,968.

96. In support of the Liquidators' contention that the Company was or became insolvent as a result of the alleged distributions, they rely on:

    i) LBC changing its payments terms in July 2010, reducing the Company's fee income by approximately 20 per cent, in circumstances where the Company was operating under margins of 18-22 per cent;

    ii) the First Respondent stating in his directors' disqualification questionnaire that he first became aware of the Company's insolvency when LBC made cuts to the Company's income, which he also attributed to its insolvency;

iii) the First Respondent being reported to have said during his meeting with the Company's accountants in September 2010 that the Company had recently experienced cash flow difficulties, for the first time had run out of money and had to approach its bank for an overdraft facility;

iv) evidence gathered by the Liquidators' staff of creditors pursuing outstanding debts from the Company including by statutory demand, county court proceeding and default judgment and, in relation to council tax arrears for the periods May to July 2007 and October to November 2011, council tax summonses;

v) evidence of debts claimed by creditors in the liquidation which pre-dated the alleged distribution payments; and

vi) that Ms Smith met Mr Atkinson in March 2011 seeking specialist insolvency advice and that 8 months after the payments were made, the Company entered administration in respect of which Ms Smith approved a statement of affairs dated 25 October 2011 showing an estimated net deficiency of approximately £39,000.

97. The 2009 accounts were approved by both its directors. Whilst the Liquidators have sought to undermine them particularly in relation to the updating of the SAGE records, the accountants prepared the accounts at a time when they could have questioned figures or requested further information before completing them. I find that on the balance of probabilities, Mc Brides would have been in a better position to ensure their accuracy than the Liquidators who came to review them several years later. The Liquidators' custody of the SAGE records appears to have been far from perfect and during cross-examination, Mr Atkinson was not in a position to explain how those difficulties arose. He confirmed that he was not aware of any enquiries having been made of McBrides and he was not in a position to say whether his staff had had access to the full Company records.

98. In my judgment, the Second Respondent was entitled to rely on the accounts prepared by their accountant being accurate to the date to which they were prepared, namely to 31 March 2009.

99. Mr Ascroft acknowledges that the existence of distributable reserves in the last relevant accounts is not determinative of the Company's ability lawfully to make a distribution and that its directors, when authorising a distribution, must also act in accordance with their statutory duties under chapter 2 of Part 10 CA06.

100. Ms Smith's evidence is that the proposed dividends were provisionally approved at the December 2010 Meeting but in accordance with that agreement, she did not withdraw the Second Payment from the Company's accounts until 20 January 2011, once the Company had received the net proceeds of sale from the Ashmore Road development. That was some 22 months after the date of the March 2009 accounts. Updated financial information would therefore be required for the directors to be able to have satisfied themselves that the distribution was not being paid out of capital.

101. As I have already noted, Ms Smith states that she prepared an up-to-date summary showing the anticipated realisations and a schedule of the creditors that would need to

be paid but that despite searching, having moved home in the eight years that have passed, she cannot now find them.

102. She asserts that the schedule would have shown how she took all sums due to creditors into account before deciding the amount which could be paid to herself and the First Respondent.

103. Addressing each of the points summarised at paragraph 96 above:

i) It is Ms Smith's case that LBC's cuts would not start to impact the Company until July 2012.

ii) The First Respondent was not called to give evidence in relation to the statements he is reported to have made at the meeting with the Company's accountants. His reported statement is heresay and inadmissible as evidence of the Company having run out of money. Ms Smith concedes that the Company had temporary liquidity problems but maintains that it was in the process of selling its assets to create liquid funds and in the meantime, remedied the issue, as many other companies do, by seeking a temporary bank overdraft facility.

iii) Ms Smith claims that the Company's delayed payments to creditors arose as a result of the First Respondent's refusal to countersign cheques. This arose in February 2011 after she restricted his sole access to any of the Company's bank accounts. Whilst the First Respondent's refusal to sign cheques may have resulted in the Company failing to pay some invoices, Ms McGowan clearly demonstrated to the Court whilst cross-examining Ms Smith that it could not have been the case for several others which pre-dated February 2011. Examples include:

- Fathom Business Solutions who commenced county court proceedings on 11 January 2011 in respect of an unpaid invoice for £504 dated 1 April 2010;

- Direct Hygiene who claimed £94 in a letter dated 20 January 2011 in which the amount was said to be "seriously overdue"; and

- £1,913 owed to G and P Cleaning Services who had obtained a default judgment against the Company by 9 February 2011.

iv) Ms Smith's evidence is that when she met Mr Atkinson in March 2011, she did not consider the Company was insolvent at the time. She had originally wanted the assistance of a mediator to help with the impasse between herself and the First Respondent to wind down the business. She asserts that she was not presented with any possible alternatives to administration.

In her directors' questionnaire she replied to the question "when, and in what circumstances, did you first become aware of the company's insolvency?":

"At no time was insolvency an issue. Our own forecasts indicated we would start to face temporary liquidity issues from March 2011 onwards. Unless a

strong action plan was agreed and implemented then it was inevitable that this would lead to insolvency within a few months".

In response to the question: "What steps did you personally take on becoming aware of the company's insolvency?" she said:

> "I presented RAK with a detailed strategy at our last Board meeting on 3 March 2011 (agenda attached) to enable all debts to be paid and the company could then cease to trade and we would go our separate ways".

v) Ms Smith claims that as a result of the First Respondent's refusal to agree to the wind-down process she had proposed, properties to landlords were not returned smoothly, resulting in the Company being unable to contest their claims for dilapidations, the Company's property-management functions lapsed and staff stayed a month longer than she considered would have been necessary, resulting in increased creditor claims in the liquidation.

104. One of the most significant debts, allegedly due from the Company relates to LBC in respect of overpayments which it made to the Company. Bearing in mind the size of the figures which have been intimated, the amount, if anything, has proved to be surprisingly nebulous:

i) Mr Atkinson's notes of his first meeting with the First Respondent on 1 October 2010 record that LBC had an overpayment claim against the Company for £30,000 but was also a debtor of the Company for £60,000.

ii) The notes of Mr Atkinson's meeting with Ms Smith on 2 March 2011 refer to overpayments from LBC of £363,000. To the right of this amount is a note, which may or may not refer to it, which states "over 5yrs" and another which appears to state "contra against bad debt provision". Further down the page there is a note saying "Some underpayments 267,000" and "etr nil". I understand "etr" to mean "estimated to realise". The schedule also includes, among details of other assets at the bottom of the page, " 37a Kingswood Rd - Property Proceeds - £190,000 – end next week" and "Glencorn - Property - £100,000".

iii) Mr Atkinson has entered in evidence a schedule which he states Ms Smith gave the Liquidators when the Company entered administration which he understood to be intended to provide up-to-date information regarding LBC's overpayment claim. The total figure is £789,712.41. However, Mr Atkinson's staff considered that they had identified an error in the calculation, reviewed the information and arrived at a figure of £634,209.

iv) The statement of affairs signed by Ms Smith when the Company entered administration, included LBC as a creditor for only £1 with an accompanying note: "This figure remains uncertain as it would involve a reconciliation going back 10 years. The cost/benefit analysis needs to be considered".

v) To date, LBC has not submitted any claim in the liquidation.

Were the dividend payments lawful?

105. The First and Second Payments were authorised at a time when the Company's last accounts showed more than £500,000 distributable profits. In my judgment, having failed to make enquiries of the accountants who prepared them, and having chosen not to put in evidence the SAGE records which the Liquidators contend do not correlate to the figures in the accounts, the Liquidators attempts to undermine those accounts failed. I find therefore that the Second Respondent was entitled to rely upon those accounts when considering whether to authorise the Payments.

106. The information in the accounts nevertheless required updating. The Company was not paying all of its creditors on time. In *Casa Estates (UK) Ltd* [2014] EWCA Civ 383 Lewison J cautioned against confusing temporary cash flow issues with evidence of insolvency for the purposes of a claim against directors for breach of duty.

107. Whilst delaying payments to creditors may suggest that a company is insolvent on a cash flow basis, I accept Ms Smith's evidence that the Company was in the process of selling substantial properties and that it was a temporary liquidity problem. Her evidence that the problems were remedied by the bank overdraft facility was not challenged.

108. Her evidence that LBC's reduced rates would not impact the Company's business for several months was not undermined by the Liquidators: they did not produce any evidence or information from LBC. They relied upon the statement in the First Respondent's directors' questionnaire (even though, or perhaps because he had been shown to have made dishonest statements regarding the First Payment) without calling him to give evidence;

109. It is Ms Smith's case that the dividends were paid for the period to 31 March 2011. On that date, and after the Payments had been made, the Company still had £284,546.82 in its current account at HSBC. A further property was sold in July 2011 for £84,730 and the Company had monies standing in a tenant account which Ms Smith states fluctuated in January between £3,800 and £13,280. The company owned various assets including cars which the Liquidators subsequently realised for £7,150.

110. Ms Smith states:

> "notwithstanding other cash resources, from mid-February 2011 onwards, the cash position was circa £320,000 that is to say £311,000 from the sale of the Milkwood Road properties plus an average balance of £11,000 in the Tenant Account. At no material time has the sum of Company creditors exceeded this figure (which is arrived at after allowing for the First, Second and Third Payments). The Company also has other assets including the freehold properties referred to in paragraph 13 above".

111. The Liquidators have challenged her statement regarding creditor claims not exceeding £320,000 by reference to the statement of affairs which she signed in October of the same year, showing creditor claims of £376,000. Ms Smith says the impasse between the Company's directors was largely responsible for the increase in creditor claims. She maintains that she has been unable to provide any documentary evidence to support her statement, due to her inability properly to interrogate the SAGE records.

112. Ms Smith consistently maintained throughout cross-examination that it was correct to say that LBC had a claim against the Company for overpayments but that the Company had a claim which could be set off against it, in respect of underpayments. She said she did not recall giving the Liquidators the schedule showing overpayments of £789,712.41 but that if she had done so, she would also have provided a schedule showing the value of the Company's underpayment claim.

113. In my judgment, Ms Smith's contention that sums were due *from* LBC as well as due *to* it, is supported by (a) the First Respondent's statement that LBC was a net debtor of the Company; (b) the reference to "some underpayments £267,000" in the notes Mr Atkinson took of his meeting with Ms Smith – it is not clear whether the underpayment figure (if indeed that is what it was) was deducted from the overpayment amount. The figures suggest to me that it was not; and most compellingly (c) that in the past 9 years, LBC has not, in fact, lodged a claim in the liquidation.

114. The statement of affairs includes only £1 for LBC. Of the £39,000 deficiency to creditors, approximately £38,900 was due to Ms Smith (in respect of a £25,000 investment loan on a property at Glencairn Road, plus preferential and non-preferential amounts for unpaid salary and redundancy pay).

115. Ultimately, whilst the statement of affairs anticipated creditor claims of £376,000, to date, the Liquidator has only received claims for £275,000.

116. Whilst Mr Atkinson informed the Court that some creditors choose not to prove, and Ms Smith asserts that some of the amounts claimed have been grossly inflated by creditors (for which she has failed to provide supporting evidence) the fact that ultimately only £275,000 has been claimed by creditors against asset realisations (including £215,000 cash at bank and £65,000 in the tenant account) which exceed that figure, in my judgment supports Ms Smith's statement that at the time the Payments were made, the Company would have sufficient funds to meet all creditor claims.

117. The significant shortfall to creditors now arises as a result of the costs and expenses of the Company's administration and liquidation.

Conclusion regarding the First and Second Payments as dividends

118. Taking all factors and evidence into account, I find on the balance of probabilities that the Company was solvent at the time the Payments were made. Ms Smith is entitled to rely on the principle in *Duomatic:* as all of the Company's shareholders who had a right to attend and vote at a general meeting agreed to the proposed Payments at the December 2010 Meeting, their agreement is as binding as a resolution in general meeting to make lawful distributions.

119. I find on the balance of probabilities that notwithstanding the Company's temporary liquidity problems, the Company had sufficient assets to be able to be wound down in a manner which should have allowed all of its liabilities to be paid as well as funding distributions comprising the First and Second Payments.

120. It follows that in my judgment, when authorising and permitting the First and latterly the Second Payment to be made, Ms Smith did not breach her common law duties to

the Company nor the statutory duties she owed as a director as set out in sections 171, 172 and 174 CA06.

The Third Payment

121. The issue to be determined is whether, when making a payment on 20 January 2011 for £31,126 by bankers draft drawn on the Company's main HSBC account in favour of Ms Smith, the payment was for no consideration and as a result, that she breached her duties pursuant to sections 171 and 172 CA06.

122. As the Liquidators have provided evidence of the payment having been made, the burden of proof is on Ms Smith to show that it was a legitimate use of the Company's money.

123. Ms Smith claims that the Third Payment was to discharge the sums claimed in an invoice dated 14 December 2010 for the same amount from the Johnson Samuel Partnership ("JSP") whose principal, Paul Gray was her former partner. It is her case that Mr Gray was in New York at the time and although JSP maintained its own bank account, he had failed to take with him to New York the bank-issued device required to gain remote access to the account. He asked Ms Smith to pay the amount of the invoice into a bank account held in their joint names, from which he could make online payments to third parties. Ms Smith states that she had not used the joint account since 2009 when her personal relationship with Gray broke down.

124. In her witness statement she states:

> "The vast majority of payments to JS were processed online and paid into the JS bank account. … Mr Gray was overseas at the relevant time and without the ability to apply any payment made direct to JS for its purposes. Mr Gray (my former partner) had never received a payment in his name from the Company and so he was not set up as a creditor on SAGE. At the time and in hindsight I should have just set him up as an individual on SAGE and made the draft payable to him but it was simply another thing to do during an incredibly difficult and demanding time. I was being pulled all over the place from all angles of the business – R1, staff, landlords, trade creditors, tenants and the local authority. I therefore agreed to settle the invoice by Bank Draft drawn in my name but recorded on SAGE creditors' ledger as a payment firstly to myself and then onward transmission (journal) to JS against the invoice number that I already had in my possession.
>
> JS had been providing services to the company since 2004. They were a well-established creditor of the company. I estimate that the company received more than 250 invoices from this creditor during the period 2004 - 2011. There can be no dispute that a valid invoice was not received".

125. When giving evidence during the trial she said that the money had been paid via a banker's draft because the Company had already exceeded its BACs transfer limit that day and the money was required urgently - a cheque would have taken 5 to 7 days to clear whereas a banker's draft clears immediately.

126. The invoice was not among the Company's books and records. Ms Smith provided a copy in August 2014. It was sent to her by email from Mr Gray. In the same email he declined to provide bank statements for the account into which the monies were paid on the basis that although it was in their joint names, she never used it and he considered it appropriate that he had removed her from the account after they split up.

127. The Liquidators have provided copies of three cheques payable to Mr Gray personally for £1966, £2,513 and £2,955. Each was signed by Ms Smith on behalf of the Company and dated 20 January 2011, the same date as the banker's draft used to make the Third Payment.

128. The cheques appear to contradict Ms Smith's statement that Mr Gray was not set up on the Company's SAGE accounting system. However, taking into account the following factors, I find, on the balance of probabilities, that the Third Payment was, as asserted by Ms Smith, not for her own benefit but paid in the manner and for the other reasons she gave, to discharge JSP's invoice dated 14 December 2010:

    i) the Liquidators conceded that the Company had a prior trading relationship with JSP;

    ii) no evidence has been advanced to show that the invoice has been fabricated;

    iii) the amount of the payment (£31,126.00) is not a round sum and would be a curious figure to pluck out of the air for the purposes of siphoning away Company money;

    iv) the amount correlates precisely to the amount claimed in the invoice;

    v) Ms Smith has provided a credible explanation why the payment was made by draft (the BACS limit was exceeded that day); and

    vi) she has consistently given broadly the same explanation since July 2014 when the matter was first raised with her, more than three and a half years before the Liquidators amended their Points of Claim to include a reference to the Third Payment.

129. In my judgment, Ms Smith did not breach her statutory or common law duties to the Company when making the Third Payment.

Conclusion

130. For the reasons I have given, I dismiss the Liquidators' claim.

Insolvency and Companies Court Judge Burton
3 November 2020